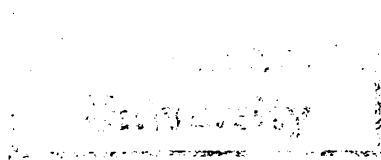




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Paul M. Lane

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PRODUCT MARKET RISK

A Theoretical Development of the Concept of Risk
in the Product Market and its Impact on
Management Decisions in the Capital and
Resource Markets

by

Paul M. Lane

A DISSERTATION

Submitted to
Michigan State University
in partial fulfillment of the requirements
for the degree of

DOCTOR OF PHILOSOPHY

Department of Marketing and Transportation

1986

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ABSTRACT

PRODUCT MARKET RISK

A THEORETICAL DEVELOPMENT OF THE CONCEPT OF RISK IN THE PRODUCT MARKET AND ITS IMPACT ON MANAGEMENT DECISIONS IN THE CAPITAL AND RESOURCE MARKETS

By

Paul M. Lane

The purpose of this inductive research study was to explore a new structural concept labelled presence. Presence is defined as the carry-over potential of a product or brand into future markets. In order to explore the concept it was necessary to review the framework of product market risk in marketing and finance. The research was conceptualized around the future oriented risk and return framework found in finance.

Field research was conducted using a convenience sample of twenty financial analysts. In-depth interviews were transcribed and content analyzed to provide the information base.

Examination of the factors that analysts cited as impacting their valuation methods was the central focus of the interviews with a particular emphasis on trying to understand how product market information is used. These factors divided themselves into three major areas: (1) product market performance, (2) corporate performance, and (3) financial market performance.

A classification scheme for the factors was developed that helps to understand how product market risk is used in the financial evaluation process. This observation was used to help better understand how

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marketing and financial theory could be used to more fully understand product market risk and the potential of the concept of presence.

It is suggested that there is a potential to develop a structure for investigating future markets in the form of presence. Additionally, in a symbiotic way, further exploration into product market risk may help both concepts. There is a rich theory base for marketers to draw on in the finance area.

This was an inductive piece whose purpose was to explore and develop a new concept. The work has provided a structure and a framework for further inductive research leading to a more definitive model.

For my wife, Bonnie, family, and friends who have shared
in the process which led to this accomplishment.

ACKNOWLEDGMENTS

The support, encouragement and expectations of many people were an integral part of the graduate experience from which this dissertation evolved.

Special thanks are due to the Dissertation Committee members, Dr. Forrest "Sam" Carter, Chair, Dr. Dale Duhan, and Dr. Ronald Savitt who ensured that the process was intellectually stimulating and enriching. Gratitude is also due to doctoral colleagues Catherine Nancy Axinn, Sharon V. Thach, to my assistant of many years Inez Brown, to a tireless graduate assistant, Scott Freeman, and to Doris Statler and my father, Malcom V. Lane for their patient editorial work.

To members of my family, I am grateful for the support and patiences, which help me to carry this project through to completion.

TABLE OF CONTENTS

List of Tables.....	viii
List of Figures.....	ix
 Chapter	
One	
INTRODUCTION.....	1
DESCRIPTION OF THE CONCEPT.....	4
Reward Structure.....	5
Measures.....	7
Need for New Concept.....	9
Customer-based, Long-Term Concept.....	9
Resource Allocation.....	11
Management Performance Measures.....	12
Increased Market Value.....	13
Satisfaction Is a Key to Marketing.....	15
Elements of Presence.....	16
Conclusion.....	18
RESEARCH PLAN.....	19
Organization of Research.....	19
Research Questions.....	20
 Two	
MARKETING LITERATURE REVIEW.....	22
Introduction.....	22
Economics.....	23
Marketing and Ownership.....	29
Marketing.....	31
Marketing Investment.....	32
Management of Presence.....	35
Product Market Risk.....	38
The Development of Presence.....	38
Presence a Process Measure.....	41
Summative Measures.....	43
Goals and Objectives.....	45

	Product Market Risk and Related Marketing Concept.....	50
	Entrepreneurship.....	50
	Environmental Molding or Shaping.....	53
	A Time Space Perspective.....	55
	Conclusion.....	56
Three	REVIEW OF FINANCE LITERATURE.....	57
	Efficient Market Theory.....	57
	Macro Models.....	59
	Valuation of Securities.....	60
	Capital Asset Pricing Model.....	61
	Cash Flow Models.....	65
	Dividend Payout Model.....	65
	Earnings Growth Model.....	67
	Present Value of Discounted Cash Flow.....	67
	Price Based Models.....	68
	Book Value.....	70
	Marketing Investment and the Cost of Capital.....	71
	Analyst Role.....	74
	Conclusion.....	75
Four	METHODOLOGY.....	77
	Introduction.....	77
	Inductivist Approach.....	77
	Rationale.....	78
	Sample.....	81
	Personal Interviews.....	82
	Design.....	88
	Factors for Interviews.....	90
	Interview Structure and Questionnaire.....	94
	Expectations.....	98
	Content Analysis.....	102
	Coding.....	103
	Frequencies.....	111
	Crosstabulations.....	111

	Conclusion.....	114
Five	RESULTS.....	115
	General Information.....	115
	Results by Research Questions.....	119
	Research Question One.....	119
	Research Question Two.....	125
	Research Question Three.....	132
	Research Question Four.....	136
	Conclusion.....	143
Six	IMPACT OF PRODUCT MARKET RISK.....	144
	Development of Model.....	144
	Relating of Product Market Performance to	
	Financial Market Performance.....	149
	Financial Market Performance.....	153
	Investor Objectives.....	157
	Analyst Do Not Focus on Product Markets.	160
	Corporate Filter on the Results of	
	Product Market Performance.....	171
	SBU Filter on Product Market	
	Performance.....	177
	Customer Behavior.....	181
	Financial Analyst Have an Unclear View	
	of Product Markets.....	186
	Tiers of Influence.....	192
	Conclusion.....	198
Seven	IMPLICATIONS.....	199
	Introduction.....	199
	Product Market Risk and The Financial Analyst...	199
	Financial Markets Future Oriented.....	199
	Focus on Stocks.....	200
	Future Earnings Derived in Part from	
	Product Markets.....	201
	Risk.....	205

Short-Term vs. Long Term Scenarios.....	208
Presence Is an Intangible Asset Like Goodwill.....	209
Product Market Risk Factors Used by Financial Analysts.....	211
Product Market Risk and Marketing Strategy.....	214
Presence and Market Definition.....	214
Presence and Related Marketing Concepts.....	215
The Concept of Presence as a Performance Measure.....	223
Presence as a Strategic Tool.....	225
Marketing Mix and Risk.....	247
Formalization of Model.....	250
Future Directions.....	259
Research Questions.....	260
Conclusion.....	262
Appendix	
A-1 Individual Content Analysis Masters.....	264
Bibliography.....	284
General References.....	289

LIST OF TABLES

1.	INTERVIEWEES JOB CLASSIFICATION.....	116
2.	INDUSTRIES FOLLOWED BY RESPONDENTS.....	117
3.	LOCATION OF RESPONDENTS.....	117
4.	BUYSELL CLASSIFICATION.....	118
5.	FACTORS MENTIONED BY SELLSIDE.....	118
6.	OFFICIAL TIME HORIZONS.....	120
7.	IDEAS MENTIONED BY ANALYST WITH 0-24 MONTH OFFICIAL HORIZON.....	121
8.	ANALYSTS HORIZON FOR VALUATION.....	122
9.	ITEMS MENTIONED WITH 25-60 MONTH FOCUS.....	122
10.	DISTRIBUTION OF HOLDING PERIODS.....	123
11.	ITEMS MENTIONED WITH SHORT-TERM HOLDING.....	123
12.	ITEMS MENTIONED BY ANALYST WITH TWO TIERED HOLDING PERIODS.....	124
13.	INDUSTRY CONTENT ITEMS.....	126
14.	TYPES OF PRODUCT MARKET RESEARCH.....	127
15.	ITEMS MENTIONED BY PURCHASERS OF PRODUCT MARKET RESEARCH.....	128
16.	ITEMS MENTIONED BY THOSE DOING IN HOUSE PRODUCT MARKET RESEARCH.....	129
17.	ITEMS MENTIONED BY THOSE WITH FUTURE ORIENTATION.....	130
18.	ITEMS MENTIONED BY THOSE SEEKING CUSTOMER INFORMATION.....	131
19.	SUB-PARTS OF CUSTOMER RESEARCH.....	131
20.	FACTORS IN VALUATION.....	133
21.	ITEMS OMITTED BY THOSE USING EARNINGS FOCUS....	134
22.	FACTORS USED IN EVALUATING A FIRMS FUTURE.....	138

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LIST OF FIGURES

1. MACRO-MARKET MODEL.....	24
2. A CONCEPTUALIZATION OF THE CONSUMER PROCESS IN CONSIDERING BRAND.....	42
3. EXTENDED PRODUCT LIFE CYCLE.....	46
4. SAMPLE LIST.....	83
5. CONFIRMATION LETTER.....	85
6. SYNOPSIS.....	86
7. FIRM INDUSTRY MATRIX.....	89
8. FACTORS TO BE DISCUSSED WITH ANALYST.....	91
9. INTEVIEW STRUCTURE AND QUESTIONNAIRE.....	95
10. CONTENT ANALYSIS MASTER.....	104
11. TYPICAL CROSS TABULATION.....	113
12. PRELIMINARY PRODUCT-FINANCIAL MARKET LINK.....	145
13. REVISED PRODUCT-FINANCIAL MARKET LINK.....	147
14. FURTHER REVISED PRODUCT-FINANCIAL MARKET LINK.....	148
15. RELATIONSHIP OF PMP AND FMP.....	150
16. MACRO MARKET INFLUENCES.....	154
17. INVESTORS.....	158
18. INFORMATION FLOW IN INVESTMENT COMMUNITY.....	161
19. VALUATION FACTORS.....	166
20. DIVIDEND DISCOUNT MODEL.....	168
21. FINANCIAL MARKET RISK.....	170
22. FACTORS THAT IMPACT CORPORATE PERFORMANCE.....	178
23. FACTORS THAT IMPACT SBU PERFORMANCE.....	182
24. CUSTOMERS IN THE PRODUCT MARKET.....	183
25. ELEMENTS LEADING TO BEHAVIORIAL ACTION.....	185
26. PRODUCT MARKET FILTERS.....	187
27. RELATIONSHIP OF PMP AND FMP.....	188
28. TIERS OF INFLUENCE.....	193
29. STOCK/COMPANY MATRIX.....	202

30. PRESENCE/GOODWILL VENN DIAGRAM.....	210
31. GE PORTFOLIO MODEL.....	217
32. ADVANTAGE TIME PLANE.....	222
33. B.C.G. MODELS.....	229
34. PRODUCT MARKET MATRIX.....	236
35. REVISED PRODUCT MARKET MATRIX.....	237
36. SHADED, REVISED PRODUCT MARKET MATRIX.....	238
37. PRODUCT LIFE CYCLES AND SALES GOALS.....	241
38. PRODUCT MODEL.....	248
39. MODEL USERS.....	253
40. ANALYSTS FROM DECENTRALIZED FIRMS.....	256

Chapter One

INTRODUCTION

This research has followed an inductive process as opposed to a deductive process. There is not a theory in the area being studied and therefore no hypothesis could be developed, (a detailed discussion of the deductive process is found at the beginning of chapter four).

Management in the United States has been accused of being shortsighted. The lack of long-term planning and market investment has been a focal point in discussions concerning the difficult time United States firms have in meeting foreign competition. One reason for this shortsightedness has been attributed to the reward systems for management.

...Bonus plans based on measures such as growth in earnings per share lead to the establishment of goals that have little or nothing to do with shareholder-value creation. They provide the temptation to pump up short-term earnings through strategies that may be detrimental to sustained high relative performance and the consequent creation of shareholder value. For example, the arbitrary reduction of R and D spending, postponement of investment in more efficient plant and equipment, and the continued support of marginal operations are all telltale signs of short sighted management.(Booz, Allen and Hamilton Inc.)

Rewards systems tend to be based on return-oriented accounting period measures such as profits and sales, and are therefore historical or current in nature. They do not carry information about the future. That United

States managers tend to be committed to their career path rather than to the organization and that performance measurements are based on hindsight encourage short-term thinking.

New concepts and additional measures, for longer term accountability are needed. These should indicate the long-term impact of today's product market actions. That the firm's situation in the product market has improved to a position of strength would indicate a strong positive carry over (reduced risk) in the future. This would be useful to management and investors looking at how the value of market position has increased as a result of past marketing action. In addition, this is one of the phenomena that should be operationalized to help improve and develop a longer-term orientation of the measurement and reward system.

The key to marketing is the satisfaction of customers; therefore, the carry over phenomenon and the measures associated with it should focus on the perceptual framework of the consumer. It is the consumers' perceptions that determine the acceptance of brands in current markets and the carryover influences future acceptance. The uncertainty, associated with customers' future acceptance of existing brands; the likelihood of the firm having new brands; and the uncertainty of customers' future acceptance of the new brands is defined as product market risk.

The condition which describes to what extent the acceptance of brands in current markets carries over, or can be carried over, to existing and new offerings in future markets is defined as "presence" for this dissertation. This carry over could be positive or negative, but for purposes of this discussion only the positive carry over will be considered. The existence of presence, positive carry over, implies less volatility and

risk in the unknown future of the product markets. Strong presence, then, is conceptualized as current or forthcoming low product market risk. It may be applied to a brand, a line, or the products of a strategic business unit (SBU).

The research will focus on gaining insight into product market risk by distinguishing the concept of presence from traditional measures: sales, growth rate, market share, return on investment (ROI), and so forth. Theoretical development can be aided by understanding whether current measures are really indicators of product market risk. This is a phenomenon that is not assessed by current measures.

In addition, the research will evaluate the constructs of the concept of presence. One area would be to consider is how presence relates to competitive ability in unknown future environments. There are a number of financial measures based on risk and return that are used to speculate on the future of the firm. Financial markets are, in essence, places to invest in the future. Presence defines an expectation of stability for the future in the product markets and therefore is at the nexus of the financial and product markets. Presence, as a concept of volatility (risk) in the product market, could be contrasted with the information provided by the more traditional financial measures.

Presence is a new concept based on product market risk and the emphasis of this dissertation is to distinguish it better from the currently used measures and explore its potential effectiveness. Presence is a concept to assist with the evaluation of the allocation of resources for long-term marketing investment.

DESCRIPTION OF THE CONCEPT

Management is too shortsighted. Shortsightedness in this context implies a short-term approach, less than two years, and frequently only the current financial period. This is a condition created through a number of environmental problems. Some of these problems are caused by the operation of the financial markets, reward structures, and performance measures, to mention a few.

It would be helpful to understand how marketing management decisions of today affect the position of the firm in future planning horizons, two to five years ahead. The problem is one in which traditional measures, accounting, financial, and marketing do not provide the appropriate information needed to understand how current marketing decisions in the product markets may impact the future of the firm in the product or financial markets and the way in which the market evolves (Kirzner, 1982).

The demands of the financial marketplace have had a lot to do with short-term perspectives of United States management. The financial markets are big and powerful and not controlled by a few major institutions as in some countries. The financial community's obsession with the next period's earnings and rate of earnings growth clearly has an impact on short-term thinking. If the financial community focused more on total long-range risk and return, then management would be similarly inclined.

There are a number of ways in which the dominance of quarterly reports and annual statements impact strategic product market planning. Some of these are the influence of the Generally Accepted Accounting Principles (GAAP) and the regulations of the Internal Revenue Service and

the Securities Exchange Commission. These, in general, are not oriented to long-term intangible investments as, with the possible exception of Research and Development (R & D), only tangible items can be capitalized and amortized over their life. There are many things that could be done by management that would improve profits and earnings in later periods that may not be considered because of the necessity of expensing these items on the current profit.

An example of the problems created by GAAP can be seen with a closer look at marketing investment. All marketing items, with the exception of research and development, are expensed in the immediate period. Thus, a strategy for improving market position must have a current period payoff or the profit will be hurt. This problem has complex ramifications for marketing managers. On the one hand, good marketing suggests developing a long-term strategic plan. The regulations and principles, in combination with the financial market's emphasis on period profits, make it difficult to invest in any long-range profit making expenditures that may adversely impact profit in the current period.

Reward Structure

The reward structure further complicates the question of investment for the future. Most rewards are tied to profits or other historical measures such as sales, growth rates, market share, and ROI. These can come close to being current with today's technology. Since the rewards are tied to historical information at the end of a given period, there is little incentive to make allocations for more distant periods. Management is encouraged to allocate resources to the current period to maximize the indices on which they will be measured, a natural response, and a

shortsighted one that does not encourage taking advantage of longer-term opportunities to shape the very nature of their competitive situation.

The reward structures are affected by two major components indirectly related to management's preoccupation with the financial market's view of what is happening to the firm. Major factors that contribute to management's concentration on the short-term are the goals and the career commitment of management.

Organizations are composed of a number of different constituents including stockholders, management, workers, customers and so forth. Unless there is one primary objective or goal of the firm, so that the reward structure can be based on the movement of the firm toward that goal, there will be a suboptimization of the goals (Anderson, p. 17). The tendency of management in the U.S. is to be educated with the neoclassical economic model where the sole objective is to maximize the dollar amount of the firm's single-period profits (Anderson, p. 16). This is a very short-range view and unrealistic for complex organizations with any type of long-range planning needs. Further, it appears to be in contrast with some of the other goals that are frequently discussed, including longer-range maximization of shareholder wealth.

The impact of the neoclassical approach is to base rewards on measures of historical and current period information. This encourages the short-term approach and discourages longer-term planning. There is a tendency to overlook the long-range effects on profits or projects leading to competitive advantage in the future (Wensley, p. 178). It also ignores the long-range implications of the established link between customer satisfaction and profits (Pickle and Rungeling) or the marketing concept (Levitt 1983, Kotler *et al*). The focus of the neoclassical model on

immediate profits forces a short-range perspective on management.

The career commitment of employees is another factor that contributes to short-term focus. In the United States, employees are mobile and not loyal or committed to an individual corporation but rather to maximizing their careers. This tends to stimulate the employees to focus on the immediate return. Our universities teach the importance of career mobility to maximize salary. This kind of system encourages managers to emphasize short-term returns to improve their upward mobility. Drucker (p. 174) underscores the need of separating units with longer-range goals, such as entrepreneurial projects, from management charged with running, exploiting, or optimizing what exists.

There are, then, two strong forces impacting the short-term approach of management: the neoclassical orientation to period goals and the career as opposed to corporate commitment. Since most firms operate with borrowed funds a strong third force is the short-term emphasis of the financial community in its evaluation of the firm. Management will continue to be practically restrained to the immediate future until some way of quantifying the uncertainty of product market momentum is developed.

Measures

Almost all of the performance measures available, both in the financial and product markets, are short-term oriented with the only future or longer-term measures commonly used being guesswork or extrapolation. This forces a short-term perception on management. Without some indicator of uncertainty such as a measure of market

momentum, management will continue to be practically constrained to the immediate future.

Performance measures tend to be either firm-based or industry-based or a comparison. Firm-based measures include: Sales; growth rate brand; and, return on investment. Industry-based measures include: Sales (comparison); market share; and growth rate class (comparison).

They are all oriented to the short-term and are necessarily based on historic behavior since all are derived from sales. While technology has enabled industry to make sales based measures more current. None of these speak to the issues of customer perceptions, satisfaction, developing substitutes or changing wants or needs, which may carry over to the future.

An effective evaluation for the future should include components of both risk and return. A basic weakness in all currently used marketing performance measures is that they do not include a component of risk. Even though measures can not be made to represent the unknown and uncertain future (Loasby), marketers need to attempt to understand measurable uncertainty in the product markets, that is estimate product market risk (Knight, p. 19). This may require focusing on some critical area other than sales, such as consumer perceptions.

Resources allocated to longer-term product market projects may not show any results in sales based measures in the short-term because subtle shifts are going on among customers, including: purchasers, users, influencers, and deciders.

When there is an attempt to focus on the future this is usually accomplished by extrapolation of historical information. Extrapolation of

single-period situations, even though several may be linked together to form an historical basis fails to give any indication of product market expectations or carryover potential that the firm may have in the future. These are areas that might be better understood by exploring uncertainty in the product market and learning what areas may be measurable to define product market risk.

Need for New Concept

If the planning horizon is going to be changed to a longer-term perspective, the process can be greatly aided by development of an understanding of the kinds of conditions that are likely to reduce product market risk in the future. What is needed is an indicator of the future impact of today's marketing action. From an investment perspective, how has marketing value increased as a result of marketing action? What value can increase due to reduced risk or increased return? What are the benefits to the firm of different kinds of resource allocations?

Customer-based, Long-term Concept

Intuitively, it is impossible to measure anything in the future as the future is unknown. Thus, sales can only predict using assumptions about the future that limit or define the product market environment. One of the problems is that part of what needs to be understood to provide more useful expectations about the future is indentifying and measuring what changes may be occurring in the product market environment. This indentification and measurement of changes quantifies some of the

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uncertainty (risk).

When sales-based measures are used, all that can be expected is some form of extrapolation into the future for an individual product. This would be based on historical trends for that product and provides little or no information about why changes are occurring or how the firm is positioned to deal with change in the product markets.

The short-term view of management leads to actions based on the familiar marketing measures.

Sales
Growth Rate Brand
Growth Rate Class
ROI
Market Share
Brand Loyalty

The danger in this position for the successful firm is expressed by Robert F. Hartley (p. 87).

No firm is invulnerable to competition, no matter how well entrenched, the duration of the dominance, the extent of the resources, or the completeness of market share. Complacency tends to develop, conservatism to hold sway, and the strong inclination is to stay wedded to the traditional, the "way we have always done it."

In order to understand better the reasons why the traditional ways may need to be changed, one needs to look behind the sales to the basic marketing concepts. What are the customers' wants and needs that will drive the product markets in the longer term? To obtain this information, management has to go to the customers and try to understand them in the aggregate. Two of the major concerns that impact product markets are: The status of current products in current markets and the potential carry over into new markets (market development, diversification) and new products (product development, diversification) in the short-term and in the future? (see Figure 1)

What is needed for better long-term product market planning is the development of a product market risk measure. Measures should be customer based, and have a broader definition of market than would normally be applied to a single brand or firm. It has to be able to give a strong indication of acceptance of the firm's offerings in future markets. In the resource markets a firm is evaluated on its ability to compete in unknown and changing product markets. Firms with positive carryover or "presence" are expected to have less volatility in future product markets.

Under financial market theory, risk would be reduced by diversification. It may be that in the product markets risk is better reduced by one of the other strategies suggested in the product market matrix. In fact, in some cases the product market risk may be increased by product market diversification of a given strategic business unit.

Resource Allocation

A new concept and additional measures which indicate the long-term impact of today's actions are needed to help with resource allocation decisions. All resource allocations should be considered in light of the proposed return and the risk associated with it. Also, resource allocations for a longer-planning horizon require a performance indicator to verify that the intended return or risk reduction is developing.

The question of return is the one that is most frequently looked at by marketing management. Many of the marketing measures that are sales derived are important in projecting return in future periods.

Sales
ROI
Growth Rate

The future is unknown. The risk component which disappears from

historical measures becomes very important. In finance the value of all income is considered in light of risk and return. Risk is the quantifiable volatility of a scenario. Presence is a concept that is looking at carry over into future product markets it may be useful in quantifying uncertainty and then risk. The product markets are always subject to change. Competition, substitution, and technology can all change the product markets and are part of the uncertainty. The notion of presence is to gauge the carry-over potential of a brand or firm into future markets with new or different offerings. This carry-over potential is to be found in customer perceptions. This carry-over potential is important in current resources allocation and in, for example, future planning.

Many marketing expenditures have long-term effects, advertising (Fruhan, Ayanian) and research and development (Fruhan). In resource allocation decisions, management may want to consider not only the additional return but the risk in allocating resources to its marketing investments. The longer-term approach to product markets is probably more realistic, considering how long it takes to bring about change. To do this requires some way of indicating how the customers' perceptions of the brand, or firm, or product class are changing. Risk in the product markets is a function of the customers' perceptions of the firm's current product offerings.

Management Performance Measure

In addition to the investment criterion of resource allocation there is the performance issue. All levels of management are interested in the basis on which their rewards will be structured. Using sales-based measures, the reward is based on accounting periods that have passed by

the time the reward is given. This encourages a short-term approach and a quick return orientation. Product market risk is important to the health of a firm and it should be important in the development of performance measurement.

If management's rewards could be based in part on the carry-over or risk concept, then resource allocation and strategic planning would be handled differently. Managers would be seeking out ways to develop carry-over potential and reduce risk in the future horizons. Owners interested in the long-term growth of their firms could not only estimate sales (and return) but also have the conceptual framework for addressing risk in the product markets.

The new concept and measures are needed to help management choose its resource allocations and to define marketing performance. It is needed to help the financial community evaluate the firm and its direction of progress.

Increased Market Value

The need for a new concept and additional measures which indicate the long-term impact of today's actions can be seen if one is trying to look at how marketing value increases as a result of marketing action. Future market position has a market value and changes in this should be looked at as a performance measure of successful allocation of resources.

Money expended for advertising, with its lag effect, will benefit future period market position. An understanding of this carry over can help the evaluation of resource allocation. Similarly, with almost every area of marketing there are carry-overs.

The problem is currently, both in terms of concept and measurement,

that there is no way to handle the assessment of the market value of the future that encompasses risk (volatility). To avoid the problems of extrapolation from historical sales data there will need to be a customer-based indicator. It is not uncommon for corporations to go to the purchasers of their products for information about their perceptions, particularly with questions related to a specific product. What is needed is to look at how marketing strength is being built that may apply to future product offerings. The conceptual framework involves the examination of customers' perceptions to determine the residual market value of resource allocations. This treatment of customers' perceptions as an asset in the product market is a recognition of the effectiveness of the marketing investment that has been made.

The asset in the sense of strong customer perception may come out of a wide variety of strategic areas. Occupation of perceived quality (Sears), time (regional mall), space availability (McDonald's locations), are just a few of the possibilities. These and other factors may lead to the brand or firm being thought of as the standard (Coke, IBM, WSJ, Holiday Inn), the name being used in a generic way (Sanka, Kleenex, Jeep) in addition to a wide awareness among potential customers.

The importance of this kind of strong position cannot be overestimated when looking to the future and the volatility of the firm's position in the product market. Firms may have small share, slow growth rates, low profit margins, and so on, but, if the customers' perceptions are strong, they may be able to meet the unknown challenges of the future in a stronger position than the competition. This reduced volatility in the product markets is an asset that is not usually shown on the balance sheet.

The concept of presence is important as it would help in:

1. Understanding long-term impact of today's decisions;
2. Understanding the importance of resource allocation decisions
3. Understanding the importance of carry over in increasing market value; and,
4. Understanding the strength of a firm in the product market

Satisfaction Is a Key to Marketing

In determining what to look at to get a reading on the future it becomes clear that it is important to return to basic marketing. The key to successful marketing is customer satisfaction. Therefore, the measures associated with the carry-over phenomena should focus on the perceptual framework of the customer. Customers' perceptions determine the acceptance of brands in the current product markets and it will be the customer's perceptions that will determine the acceptance of future offerings. A modification factor to reflect this needs to be entered in the neoclassical model.

The real concern is to understand how companies' offerings will fare given known and unknown market disruptions that are likely to occur over the longer-term planning horizon. Known disruptions will come from the firm being studied. Management may know of its own plans and expectations before inducing a change into the product markets such as Coke's decision to offer the "New Coke," but naturally does not know what the response of customers and/or competition will actually be.

Management frequently does not know what other firms, inside and outside the industry, may be considering that will disrupt the product markets. Management may know of the changes but not be aware of the

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changing perceptions of customers or the rate of change. For example, it may have been possible to detect the changed perception of the United States auto buyers to using the Japanese cars as a standard long before it showed up so dramatically in the marketplace. This may be particularly true of products which are replaced less frequently.

A firm with "presence" should be able to face change in the marketplace and come out with competing changes or a new product with much less risk (volatility) than a firm without the favorable customer perception carry over into future markets. IBM was able to wait to see how the personal computer market was evolving. It even could afford to make a mistake in the PC Jr. without injuring itself in the perception of customers because of its carry-over strength from past performance.

Elements of Presence

It is early in the theoretical evolution of presence to develop a measure. The approach is to use existing measures and concepts as elements. These should be customer-based focusing on the underlying forces that marketers have theorized lead to sales. The use of these elements should help determine whether the carry-over potential is present. The suggestions are: (1) awareness, (2) composition of evoked sets, (3) brand serving as a class standard, and (4) generic use of the brand name.

Each of these could be measured separately on its own scale. The firm would find itself constantly changing on these scales as the markets shift, due to disruptions from competition, environment, or innovation. If a product brand is successful at gaining high measures on these dimensions, it should have the carry over potential into future markets that has been defined as "presence." It may be possible to develop a

composite measure of presence, perhaps in a multiplicative form that would be displayed on its own scale so that several products in the same or related classes could be compared. This would give management an idea of its position for a longer-term planning horizon and also could be used as a performance indicator if the goal is achieving long-term reduction in risk in the product markets. Rate of change is particularly important in measuring the firm's effectiveness of the allocation of marketing resources.

One of the interesting aspects of presence is that while it is conceived of as a market condition, it is not conceptualized as including sales as a component measure. The idea is to measure the perceptions about the product as strong indicators of customers' longer-term actions. The assumption is that important information is contained in the cognitive and affective area. There are a number of reasons why products could have presence in the current product market but not dominate sales or even have zero sales.

1. Lack of ability of willingness to pay (Mercedes)
2. Product has not yet reached the market (IBM PC)
3. Government intervention
 - Taxes
 - Tariffs
 - Quotas
4. Insufficient supply (Cabbage Patch Dolls)

Another reason why sales do not necessarily correlate with the concept of presence is that sales is a function of buyers' perceptions while presence exists in the perceptions of users, influencers, deciders as well as buyers. For example, users are aware of the products purchased by other users and that might have a place in presence. Presence is a

condition of the environment that can be carried over by the firm to other offerings. The shaping of the environment results from customers' perceptions and should lead to increased sales in the future. Presence is a perceptual concept while sales is a behavioral action.

CONCLUSION

The concept of presence posits that firms can establish a strong enough perception in customers so that their expectations will carry over into future markets. Strong (positive) presence represents low product market risk. Thus presence would be negatively correlated with product market risk. The concept of presence is developed out of the need to help management escape the myopia caused by single-period measures and reward systems that tend to be historically based. It is conceived to help understand the long-term impact of today's actions. From an investment perspective it is a way of looking at how a marketing value is created out of resource allocation and marketing action that is not reflected in sales related measures. Its orientation to the future requires going behind sales to the perceptions and expectations of the future. Presence is defined as the condition which describes how the acceptance of brands in current markets carries over (or can be carried over) to offerings in future markets, a condition of low product market risk. In order to develop the concept of presence which provides structure for looking at the future it is necessary in the context of this inductive research to explore the concept of product market risk. It is important to understand that the concept of presence provides a structure for looking at the unknown future. A measure of presence would help to define the uncertainty and therefore be an indicator of product market risk.

RESEARCH PLAN

Organization of Research

This research is based on the inductive process. There is no specific theory of the relationship of the financial market performance to the product market performance and no theories of product market risk or presence in this context. Without theory there can be no hypothesis and the inductive approach must be used. The basic steps listed by Hunt (p. 18 and 19) in the inductive process are (1) observation, (2) record data, (3), classification, and (4) finding a formula or conclusion. The process used in this research is as follows:

<u>Research Organization</u>	<u>Chapter(s)</u>	<u>Inductive Process</u>
Introduction	One	
Background	Two Three	
Observation	Four	Observation
Processing of Facts	Five	Record Data
Development of Model	Six	Classification of Data
Development of Generalizations and Applications for Product Market Risk and Presence.	Seven	
Suggestions for Future Research in Product Market Risk, Presence, and the Model.	Seven	

The term "research question" should not be confused with hypothesis testing. Research questions are general and provide some direction for observation.

1871. The first of these was the "Great Fire" of 1871, which destroyed the city of Chicago and its surrounding areas.

The second was the "Panic of 1873", which led to the collapse of the financial system and the onset of a depression.

The third was the "Great Depression" of 1890-1892, which was caused by a combination of factors, including over-speculation in the stock market.

The fourth was the "Panic of 1907", which was caused by a run on the banks and a collapse in the stock market.

The fifth was the "Great Depression" of 1929-1933, which was caused by a combination of factors, including over-speculation in the stock market.

The sixth was the "Panic of 1933", which was caused by a run on the banks and a collapse in the stock market.

The seventh was the "Great Depression" of 1945-1949, which was caused by a combination of factors, including over-speculation in the stock market.

The eighth was the "Panic of 1950", which was caused by a run on the banks and a collapse in the stock market.

The ninth was the "Great Depression" of 1960-1964, which was caused by a combination of factors, including over-speculation in the stock market.

The tenth was the "Panic of 1965", which was caused by a run on the banks and a collapse in the stock market.

The eleventh was the "Great Depression" of 1970-1974, which was caused by a combination of factors, including over-speculation in the stock market.

The twelfth was the "Panic of 1975", which was caused by a run on the banks and a collapse in the stock market.

The thirteenth was the "Great Depression" of 1980-1982, which was caused by a combination of factors, including over-speculation in the stock market.

The fourteenth was the "Panic of 1982", which was caused by a run on the banks and a collapse in the stock market.

Research Questions

The complexity of product market risk and presence and the early stage of their theoretical development make it difficult to operationalize in a readily quantifiable study. However, this does not leave the study without research questions.

Theoretically, the financial markets have perfect information availability of public information such as financial statements, product market information, news releases and so forth. The notable possible exception is insider information. If this is so, what is the function of the many industry specialists in banks, brokerage houses and advisory services? What kinds of information are they looking at? Their evaluation must start with use of traditional financial performance measures and models.

Performance Measures

Profits
ROI
Growth Rates

Models

CAPM
Book Value
Growth Models
Asset Valuation

They must also be subjectively appraising the future and considering other elements such as:

Management Strength
Technology
Product Market Position and Potential
(Carry Over Presence)

This study will explore financial analysts valuation of companies to understand the role of product market appraisal in the valuation process. There are four major research questions:

1. What is the relationship between stockholder objectives and the firm's objectives?

1. The first step in the process of developing a financial model is to identify the key variables that will drive the model. These variables should be based on a thorough understanding of the business and its operating environment. Once the key variables have been identified, the next step is to develop a set of assumptions for each variable. These assumptions should be based on historical data and industry trends, and should be clearly stated and documented.

2. The next step in the process is to develop the financial model itself. This involves creating a set of equations that link the key variables to the financial outcomes of interest. The model should be built in a way that allows for the input of different assumptions and the calculation of the resulting financial outcomes. Once the model has been developed, it is important to test it to ensure that it is working correctly and that the assumptions are reasonable. This can be done by comparing the model's output to historical data and industry trends, and by performing sensitivity analysis to see how the model's output changes with different assumptions.

Performance Measures	Inputs
ROI	Operating Profit
Growth Rates	Revenue Growth
	Operating Profit Growth
	Capital Expenditure

They must also be subjectively assessing the future and evaluating the assumptions such as:

- 1. Management Strategy
 - 2. Technology
 - 3. Product Market Position and Competition
 - 4. Capital Over Investment
- The study will evaluate financial analysts' valuation of the company and understand the use of product market position in the valuation process. The study will also evaluate the use of the following questions:
- 1. Which is the relationship between stock market value and the firm's performance?

How do the strategic planning goals of marketing managers, in developing products to match the needs and wants of customers, relate to the financial market goals of maximizing shareholder wealth?

2. What is the relationship of product market risk to the financial markets?

Has the financial community developed a useful measure of product market risk and how do they define it? If the product market is considered, how is it used: directly or indirectly? What is the strength of the relationship?

3. What are the needs for a marketing based product market risk measure?

How should product market risk be measured? How will product market risk impact return and what is required for analysts to use the risk measure efficiently?

4. Can evaluation be explained solely by traditional measures?

CHAPTER TWO

MARKETING LITERATURE REVIEW

Introduction

This chapter will explore the concept of product market risk in the marketing literature. Presence can not be explained directly as it is a new structural concept helping to define the unknown. Working backwards from certainty to uncertainty information on product market risk may help with the understanding of presence. The literature that will be used is diverse since marketers have not focused on product market risk. This literature review is directed at answering two of the four research questions posed in chapter one.

1. What are the needs for a marketing-based product market risk measure?
2. What is the relationship between stockholder objectives and the firm's objectives?

The development of product market risk starts with a discussion of the product markets in the macro economic model proposed by McCarthy, and then discusses product market risk or presence. Presence or low product market risk, is then compared to existing marketing measures. Its importance in relation to marketing investment is considered. Then there is a discussion of marketing and the goals and objectives of the firm out of Anderson. This is followed by a review of some of the current ideas evolving out of Austrian economics that are relevant to product market risk. This chapter is meant to provide a background for the further

understanding of product market risk in combination with chapter three which reviews the financial literature.

Economics

Economists have long recognized the relationship of the product market to the resource markets. Many introductions to marketing texts include a figure on the market directed economy showing the interactions among consumers, product markets, government, resource markets and producers (McCarthy, 1984, p. 17). This model, Figure 1, helps to clarify the importance of product market risk. Producers must attract consumers or customers in the product markets and resources, including financing, out of the resource market. It might be better to conceive of the resource market as a number of different markets providing capital, raw materials, labor, and so forth.

There has been a substantial amount of work done in the finance area examining the risk and return in the capital part of the resource markets. Very little work has been done in marketing to develop an understanding of product market risk and what it may mean to the corporate unit and its objectives. When the uncertainty of the future can be quantified or measured, it is known as risk (Knight). Referring to the model of a market directed economy, return has been studied in all the exchanges but the concept of risk has not been as fully developed. Students of business should be interested in understanding the function of risk. It is particularly relevant for marketers to pursue the development of product market risk concept. It would be useful in strategic planning and in relating the two economic based disciplines of marketing and finance at

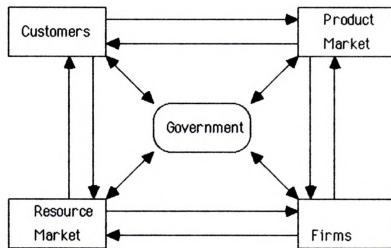


Figure 1
MACRO-MARKETING INFORMATION FLOW
Adapted from: McCarthy, 8th ed.

both conceptual and applied levels. A product market risk concept would be extremely useful in developing an integrated theory of management strategy. This would be important in understanding the relationship of risk in the resource market and product market at both the corporate and strategic business unit levels (Varadarajan, 1986, p. 20).

In marketing, much of the economic basis is neoclassical equilibrium theory with all of its assumptions, including perfect markets (Haley and Schall), known future (Kirzner), supply equaling demand (Samuelson). The neoclassical model can be found in practice. The manager is often oriented to the supervision of existing operations (Penrose, p. 31) in an environment that maintains the status quo. This acceptance of the neoclassical equilibrium in the present period is the basis for looking at future sales as an extrapolation of past sales.

FS f (past sales)

In this situation, the future is defined as the short term. The danger in this position for the successful firm is expressed by Hartley (p. 87).

No firm is invulnerable to competition, no matter how well entrenched, the duration of the dominance, the extent of the resources, or the completeness of market share. Complacency tends to develop, conservatism to hold sway, and the strong inclination is to stay welded to the traditional, the "way we have always done it."

A short term view of management would lead to actions based on the familiar marketing measures.

Sales Growth
Growth rate brand
Growth rate class
ROI
Market Share
Brand loyalty

In contrast to the short term approach the Austrian school considered

much longer horizons. The Austrians tried to understand equilibrium as it applies to the real world and pointed out the weaknesses of concentrating on the mathematics of equilibrium situations.

The mathematical economist.....They do not notice the individual speculator who aims not at the establishment of the evenly rotating economy but at profiting from an action which adjusts the conduct of affairs better to the attainment of the ends sought by acting, the best possible removal of uneasiness. They stress exclusively the imaginary state of equilibrium which the whole complex of all such actions would attain in the absence of any further change in data. They describe this imaginary equilibrium by sets of simultaneous differential equations. They fail to recognize that the state of affairs they are dealing with is a state on which there is no longer any action but only a succession of events provoked by mystical prime names. (von Mises, p. 251)

A number of authors have recognized that disruption is a process that can lead to improved equilibria and therefore should not be considered inconsistent with equilibrium theory (Loasby, Kirzner, Anderson, 1965, p. 259). Perhaps the classic argument for continual change was Schumpeter's "Creative Destruction." Because of the potential for disruption, the future can not be anticipated fully (Kirzner, 1982), or known (Loasby, p. 228). The future then contains uncertainty.

Uncertainty today is not just an occasional, temporary deviation from a reasonable predictability; it is a basic structural feature of the business environment. (Wack, p. 73)

The question of uncertainty and risk is extremely important to this discussion. There are apparently five states: (1) ignorance, (2) partial ignorance (Loasby), (3) uncertainty (Knight), (4) risk (Knight), (5) certainty. Ignorance assumes no knowledge or structure for knowledge. Partial ignorance is the normal state (Loasby) where there exist some

information but not a full structure for handling information. In uncertainty the structure can be perceived but the chances are unknown. Risk indicates that the chances have been defined. Certainty would require the event to have taken place. The concept of presence adds structure for thinking about the future. A measure of presence would contribute to defining risk.

Using the Austrian approach to equilibrium, which allows for disruption or change in the form of improvements, changes the kind of information needed in the future. Historic extrapolation is not sufficient to help with estimation and understanding of the forces at work in shaping the changes, disruption, in the marketplace. The sales-based measures are summative and do not provide explanation for the process or rate of change. What is needed by management are measures that are sensitive to the disruptions that are occurring in the marketplace. These should be attuned to the changes that are taking place among those who influence product markets: deciders, influencers, users, purchasers, and others.

Such a measure should be able to provide information about evolving market disruption(s). Disruption in the marketplace can come from outside the firm in the industry (competition), from outside the industry as currently defined (Levitt) and can be caused by the firm itself as part of its market investment strategy. The process of market disruption is continual as is evidenced by the acceptance of the product life cycle concept. Market investments by firms are made to cause change in the market place and enhance competitive advantage. This is done to either maintain risk and increase return or to maintain return and decrease risk. Such investments aimed at improving its market position may:

1. Exploit the firm's market niche, or
2. Create positive disruption of the marketplace in favor of the investing firm for the purpose of developing a niche.

Exploitation and disruption involve shaping the competitive environment to the benefit of the firm's products.

A firm may develop a current expectation for future sales by considering two component parts.

1. Historic achievement
The consideration of any evolutionary scheme requires a starting point. The overall market position held at that point which is presumably the present, will greatly affect the range of possibilities and the way in which the firm will react. This is usually determined from recordable behavioral actions such as sales.
2. Current success of marketing investment
The success that the firm is currently having shaping the environment in the product market to its favor is an indication of its ability to affect the future course of evolution in the product market.

The expectation for future sales is then a function of these two components.

FS $f(\text{Historic Achievement}) \cdot (\text{Current success of marketing investments})$

To restate the functional statement:

1. Historic achievement results from the behavioral actions, sales, and therefore is better referred to as historic behavior moving it closer to its origin.
2. It is suggested current success in marketing investment may be determined from an examination of early stages of the buyer decision process, cognition and affection, and is therefore better referred to as current cognitive and affective position, perception. This examination should consider direction and rate of change as well as current position.

FS $f(\text{Historic behavior}) \cdot (\text{Current cognitive and affective perception})$

What is needed is to look at the uncertainty in the product markets

such as the suggested cognitive and affective perception and to explore what may be quantifiable and therefore help to define product market risk. It is not possible to measure all uncertainty but, as the concept of risk and measures for it are developed in marketing, the residual amount of uncertainty can be better understood. The development of product market risk indicators should be of interest to the financial community as it may help substantially improve their risk measures. Financial risk is directly impacted by product market risk since the income stream begins with sales.

Marketing and Ownership

Marketers have done some work at attempting to look at financial models as they apply to marketing (Wensley, Cardozo) but little or no work has been done on developing customer based product market risk measures. In examining product market environmental change it may be necessary to consider information about the future (risk). What are the critical events that researchers should focus on? In finance it has been the total return of the security against risk. In marketing, measurement has focused on sales. Perhaps there are other areas that should be considered such as perceived product quality (Varadarajan, 1986, p.18).

Developing the concept of product market risk is important to bringing together goals and objectives of marketing management with the goals and objectives of stockholders. This would help bring together the interest of all groups of stakeholders in the firm: customers, suppliers, management, and ownership. All have to be concerned with the firm achieving stability for the future in the product markets. The

understanding of product market risk would lead to further benefits for all stakeholders.

The creation and maintenance of customers should be the focus of a business (Levitt, The Marketing Imagination, p.19). Suppliers presumably would also benefit from the stability of the market for their goods and services. Most importantly, owners would derive benefits if the risk level was established as low. This should have a corresponding positive impact on the price of the stock. Management, which should be concerned with stock price and survival, would also benefit as quantifiable uncertainty or risk becomes better understood. Given an acceptable return, if management can lower product market risk then opportunities for both survival and stock price should improve.

Presence, the carry over effect, provides a means structuring thinking about the minimization of product market risk in future markets. The study of presence as an indicator of low product market risk can be very important in the product markets providing an indication of the direction to which customers may be shifting. Likewise, presence may be extremely important in the financial market place. The financial market place is traditionally concerned with risk and return. The institutions in the financial markets are constantly attempting to get more information that may help improve the valuation of securities. They are looking for insights into risk and return. The development of the capital asset pricing model was an effort to understand risk and return. It was an important step forward in the financial markets. It appears that the greatest inefficiency in the resource markets is in the risk measurement area. Buzzell and Chussil suggest:

...that explicit estimates should be made of how a strategy will affect future market value. After all, corporate results are derived from the performance of the corporation's business units. (Buzzell and Chussil p. 4)

An awareness of how product market risk relates to the model of the market directed economy will help to understand this chapter which focuses on the firm (producer), the product market, and the consumer; chapter 3 which focuses on the firm, the financial resource market, and the consumer (investor). Presence is in the minds of consumers (customers) and is of importance to the producers (firms); therefore, as the concept of presence and the related product market research is developed all parts of the model of a market directed economy will be discussed (see Figure 1).

Low product market risk is a direct result of successfully applying the marketing concept. A measure of presence should indicate the marketing investment carryover in the product market for the future. It is conceived of as being useful as a strategic tool and as a means of evaluating marketing effectiveness and management performance.

Marketing

Current marketing objectives tend to focus on return. Return is a simple management objective. Marketers have traditionally focused on the short-term objective measures that are derived from sales, as opposed to measures based on achievements in the development of market advantages. These are both summative measures but are of different types. The sales-based measures provide information on what has happened or is happening and may be used to derive short-term expectations. In contrast, actual customer measures such as the level of awareness, performance,

quality service level, and so forth provide insight into longer-term market developments. The Japanese have often used these rather than the shorter-term sales based measures--perhaps because they are less interested in the quarterly and annual reports (Kotler *et al*, 1985, p. 8).

The sales-based measures have traditionally been the dominant performance measures for United States marketers because of their ease of application to operations (BEQ, ROI, CM, etc.), and the facility with which the information can be collected and understood. The sales-based measures include sales, market share, growth rates, and return on investment. All of these are direct derivatives of sales. The use of sales-based measures helps planning and production people to consider the consequences on overall operations (scale and experience effects).

Sales-based figures are also used to help motivate the corporate work force (targets, percentage rewards, bonuses, and so on). Sales figures, whether in units or dollars (currency), are easily understood by management (marketing, financial, accounting), workers, and resource market investors alike. The market performance measures derived from sales are relatively easy to understand: market share, growth rate, return on investment. These indicators are important management tools for evaluating what happened or is happening in the immediate planning horizon. However, they do not provide an indication of the product market risk.

Marketing Investment

Marketing investment for this discussion means any current period cost from which returns from the product markets may be expected in

future accounting periods. Almost all marketing items are expensed in the current year. This is done in accordance with the generally accepted accounting principles (GAAP, IRS, and SEC regulations). It is important to distinguish between this accounting treatment and the real economic life of these assets. For example:

Advertising and research and development expenditures both generate economic benefits extending substantially beyond the point in time at which the expenditure occurs. Because these expenditures are written off immediately under GAAP, an economic asset (which might be labeled "capitalized advertising" or "capitalized research and development") disappears from the balance sheet. (Fruhan, pp. 35-36)

The implied future benefit to research and development is obvious, advertising may have two effects: (1) increasing sales today, and (2) increasing sales tomorrow (Dean, p. 368). This is the kind of carry over being discussed in presence.

Advertising and research and development are the two marketing costs most commonly addressed as investments but many other marketing costs might be considered as investments.

promotion	distribution system	penetration pricing
test marketing	location	reliability
lobbying	quality	service
MIS	pioneer status	market research
product development		legal action

The problem for all marketing investments is that:

At the conceptual level the adjustments...are quite straight-forward. Operationally, the adjustments are more difficult. The difficulty arises in defining a reasonable amortization schedule...(Fruhan, p. 38).

and:

Attempts to estimate advertising depreciation and adjust accounting rates of return for the

presence of advertising have yielded conflicting results. (Ayanian, 1983, p. 350)

It is worth noting that for both advertising and research and development the period of economic durability has been found to be reasonably long (Ayanian, Clarkson, Fruhan).

Average advertising durabilities implied by advertising capital best able to explain variations in accounting rates of return across industries are in the neighborhood of 7 years. (Ayanian, 1983, p. 363).

Fruhan used six years for advertising (Fruhan, p. 55) and 10 years for research and development (IBID, p. 58). This implies investment status for these two kinds of marketing costs based on the longevity of their assumed economic life.

Kotler *et al.* provide examples of marketing investment (Kotler *et al.*, 1985, pp. 48-50).

Product Strategy

- Improved product features (compared to competition)
- Added features
- Quality
- Reliability
- Maintainability

Pricing Strategy

- Penetration (followed by marginal cost)
- Low cost maintenance (quality with economy image)

Distribution Strategy

- Sales tied to service and spare parts availability
- Service preceded sales
- Geographical rollout (sales force concentration/penetrate one area before tackling the next)

Promotion

- Advertising
- Honesty (to avoid dissonance)
- Unified Strategy

The success of marketing investment may be evaluated by what

happens to competitive advantage in the behavioral area or by looking at product market risk, for example, in the cognitive and affective areas. The process of reducing risk through marketing investment often is lengthy and extends in the future. In order to evaluate the success of the marketing investment it is necessary to evaluate what is happening to risk.

A similar model looking at product market risk might be as follows:

Market Investment---->Customers' perception of products
improved---->Greater product market stability---->Presence.---->
Less Product market risk

Improvement in customer perception of products is the process by which a firm attains greater product market stability and lowers product market risk. One method of calculating a rate of return on market investments would be to attempt an evaluation of the expected market share after the investment less the value of the current market share. Marketers, investors, and others interested in trying to refine their expectation about the future need a method to evaluate what is happening to product market risk.

Management of Presence

Marketing investment to reduce product market risk is identifiable with the entrepreneurial notion of molding or shaping the environment. The goal is to disrupt the status quo and create a slightly different competition in which the aggressor can gain competitive advantage and lower product market risk. The traditional sales based measures do not provide much help to the true entrepreneur interested in identifying where

to bring about change in the competitive market environment.

Sales based measures are important and useful to management. They do not, however, provide the manager with the information needed to determine the impact of the marketing investment for positive disruption. New measures are needed that are customer-based to measure the impact of disruption or to provide information about the strength of a product in resisting unforeseen change or disruption. These changes usually do not occur rapidly and therefore management should be able to be aware of developing disruptions by researching their customers for information about what is developing. While it is intuitively logical to allocate resources to look ahead it takes an unusual effort. As Drucker points out:

It...takes a special effort for the existing business to become entrepreneurial and innovative. The "normal" reaction is to allocate...resources to the existing business.... The temptation in the existing business is always to feed yesterday and starve tomorrow. (Drucker, 1985, p. 149)

The entrepreneurs are interested in investment for positive disruption and change based on a structure that they have conceived or perceived. The sales-based measures do not inherently include the potential to recognize market disruptions. The entrepreneurs should be interested in the disruptive changes that are going on in the market environment. This could be measured by observing consumer perception or expectations (Shackle) for the long term.

It is important to realize that change can come in many different forms. Disruptions can be covered by differentiation in the form of wholly new products to something that appears miniscule but is sufficient for customers to recognize that attribute as being noticeably different and desirable.

Product differentiation takes various forms. It may be based upon certain characteristics of the product itself; potential features, trademarks, trade names, peculiarities of the package or container, singularity in quality, design, color or style. Product differentiation may also exist with the conditions surrounding its sale (Alderson, pp. 192-193)

R.G. Lipsey suggests:

That the optimal policy is often to make your product different enough from your competitors' for the difference to be noticeable but not more so... (Lipsey, 1975, pp. 320-321)

There are a number of measures and measurement tools that are available to help researchers focus on market disruptions whether positive or negative. To use these in the positive case where a firm is attempting to develop presence, it may be most helpful to construct a composite. This composite would be helpful in the valuation of marketing investment resource allocation decisions. The measures would be important as an indicator of success of marketing investment before the development of sales.

Management must be concerned with the degree of penetration into the composite customer awareness as a measure of its marketing strategy. The depth of that penetration is a measure of the security of the position of the product in the product market. The rate and direction of change is an indicator of the risk to that position in the future. Product market risk is a quantification of the uncertainty associated with product performance and, therefore, return during the time frame under consideration. Presence, the carry over effect, provides the structure for conceptualizing the future. When a measure is developed it may help to quantify uncertainty into risk.

Product Market Risk

Product markets, like financial markets, can be considered in terms of risk and return. Management is used to understanding and estimating return, but risk has always been difficult to quantify. The concept of presence is an attempt to provide a structure for thinking about product market risk. Dealing with uncertainty in the product markets is an important part of strategic planning. It is getting more attention in the management literature in scenario planning.

Uncertainty today is not just an occasional, temporary deviation from a reasonable predictability; it is a basic structural feature of the business environment. The method used to think about and plan for the future must be made appropriate to a changed business environment. (Wack, p. 73)

Uncertainty is unlikely to be eliminated; however, any reduction of uncertainty removes some of the risk and therefore can improve the valuation of the project. In the product markets, understanding and identifying risk factors is an important area that is in need of development to help with planning at the strategic business unit level and at the corporate level.

Presence should help with understanding uncertainty, risk, and performance in the product markets.

The Development of Presence

Presence is conceived of as having four essential customer based elements: awareness, evoked sets, standard, and generic. Presence as carry over is defined as being customer-based. Strong positive presence as it is conceptualized represents low product market

risk, therefore the stability of the future. Presence as a concept provides a structure to think about the future and its uncertainty. The idea of carry over and the suggestion that it is in the customers perceptions do this. A measure of presence would not only be an indicator of presence but also could serve as an indicator product market risk. The theory of product market risk could be enhanced by the evolution of a number of concepts like presence that might help to provide structure to the problem. of what to expect in the future from both competitors and customers.

Customers' past actions are known by the company as they have shown up as sales, or lack thereof, in the recent statements. By contrast, how a customer will act the next time a purchase is contemplated is unknown from any information available in the corporate records. All that is available is the record of behavioral action. Behavioral action is a result of a number of factors in the environment that are impacting upon the potential customer as well as the corporation.

Business environments are no longer stable for either the customer or the supplier side. To assess these markets it is necessary to study what is going on in the mind of the buyer or supplier. It is proposed that this could be done by using existing marketing tools.

The first item is the customer awareness of the product. Awareness and knowledge form the two parts of the cognitive level of the decision process. This item can be measured separately but is not particularly significant alone in terms of understanding product market risk. Being in the customers awareness set (Narayana, 1975, p.1) is essential to the reduction of risk, but awareness alone will not necessarily reduce risk. On the other hand, no presence is possible without customer awareness.

The awareness set can be further broken down into the evoked set, the inert set, and the inept set.

In terms of reducing risk it is important to be in the evoked set or "...the set of brands which the buyer *actually considers* when making a specific brand choice." (Howard, 1973, p. 243). Products that are in customers' evoked sets have a greatly improved chance of being purchased. Products in the inept set have little future. Products in the inert set have neither positive nor negative connotations. The awareness and evoked set concepts have been explored and methodologies created for their measurement. (Narayana, 1975).

Another element of presence is to be the brand serving as the standard. This is one of the key components to reducing risk and one of the elements that is extremely important to the concept of presence. At issue is whether customers use the products as a standard against which other products in the product class are compared. Many times, the product that is the standard may not be the most frequently purchased because of price (real or perceived), availability, or some related factor. If the product has achieved awareness, a place in the evoked sets, and is accepted as the standard, it probably has the potential to increase its share by adjusting price or distribution.

The final component of presence is the degree to which that product name is used in a generic sense. The first three elements are essential to presence. Generic usage of the name adds to presence substantially but is not essential.

Each of these elements, awareness, evoked sets, standard, and, finally, generic use of the name can be measured separately. What is

interesting is to look at the four elements together as a firm attempts to determine if a strategic business unit has achieved presence among its customers.

Notice that these are not sales-based measures, nor do they measure the ability of customers to pay. Customers could rank a brand high on all of these categories and not purchase the product for a variety of reasons. In thinking about reducing product risk there is as much interest in what it may mean to products currently on the market as there is in what it may mean to future products (carry-over).

The combined measures can be applied to users, influencers, and deciders as well as purchasers. This is a much broader view than looking at sales alone, or at more information about the product market environment.

The importance of looking at all four pieces of of the composite is demonstrated in Figure 2. The different parts represent potential inclusion and exclusion of the four measures. Thus a generic brand could appear in some consumers' inept set. There are some who do not like Coke but do like Pepsi.

Presence a Process Measure

As proposed, a measure of product risk would be to compliment the summative measures of the product market. The summative measures are generally sales-based while the process measure is based in the customers' perceptions. The summative measures are extremely useful indicators of what has transpired in the product market. They do not, however, give an indication about the future except through extrapolation

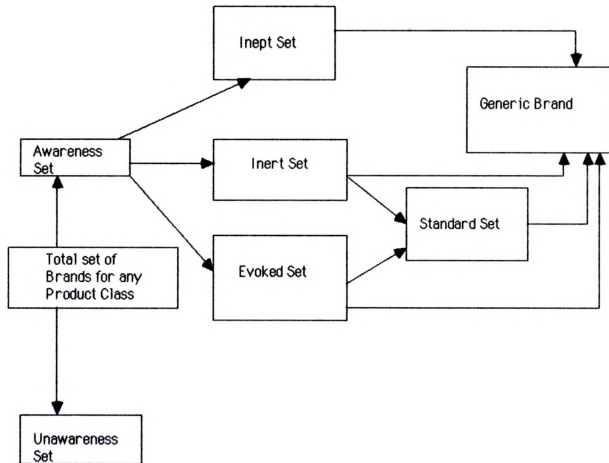


Figure 2

A CONCEPTUALIZATION OF THE CONSUMER PROCESS

Adapted from Narayana and Markim, 1975.

of trends.

Summative Measures

One of the obvious questions to ask about a measure of product market risk is how and why is it differs from the familiar market share. The answer can be developed from a review of the earlier discussions. The three relevant statements that have been made are...

1. Presence is conceived of as being measured by a composite measure of awareness, generic usage, evoked set, and having the attributes of a standard for its class.
 $P = f(A, G, E, S)$
2. (A.G.E.S.) is a function of marketing investment
 $(A.G.E.S.) = f(MI)$
3. Presence is a condition which describes how the acceptance of brands in current markets carries over (or can be carried over) to brand position in markets of the future.

Presence is not a function of sales, market share, growth rate of class, or return on investment. A brand could have a high sales level but measure low in some of the elements that make up presence. Usually they would be low in the standard category if this was the case.

It is conceivable that a brand could have presence in a related market where it does not have product entries. This might be a strength management would want to develop. A prescription drug company might find that it would have presence in the over-the-counter market.

A comparison of market share and presence show some of the attributes of the two systems that are different. This kind of listing emphasizes the differences.

Market Share
 Sales > 0

Presence
 Sales > 0

MS= <u>Sales Brand</u>	Not constrained by traditional
Sales Class	product class boundaries
Measure of objective	Measure of process
Single measure	Composite measure
Statistics internal to firm	Customer based

The concept of focusing on product market risk is very different from sales, as has been discussed. Sales is a behavioral event which carries no information about changes that are occurring among customers, particularly in their perception of products, which may influence future purchases of the same product or related products. When focusing on market share, sales becomes a goal in itself, and the achievement of that goal may not be rewarding (Woo, 1984, p. 54). Presence as a measure of low product market risk is conceived of as focusing on the stability of the product and future offerings in changing markets.

The same problems are inherent in the rest of the sales derived measures such as growth rate and return on investment. Growth rate of the class, like market share, faces the complication of definition of market. This may in itself be a limiting factor. The concept of product market risk requires looking beyond product definition to the customers and their perceptions, these perceptions also require continual reevaluation (Haley and Gatty, 1968).

Summative measures like sales, market share, growth rate, and return on investment tend to be prepared by accountants. Product market risk does not currently have measures nor a language. The proposed concept of presence would use existing marketing language and terms.

Goals and Objectives

Organizations are composed of a number of different constituents including stockholders, management, workers, customers, and so forth. Unless it is clear that there is one primary objective or goal of the firm, and that the reward structure will be based on the movement of the firm toward that goal, there will be a suboptimization of the goals (Anderson, p. 17).

Traditionally, marketers have used the neoclassical model where the sole objective is to maximize the dollar amount of the firm's single period profits (Anderson, p. 16). This is a very short-range view and unrealistic for more complex organizations with any type of long-range planning considering marketing investments. Most marketing investments for future quarters are expensed. The expense would reduce the profits in the current quarter, even though it might increase future quarter profits. If firms were truly concerned only about current quarter profits, few marketing investments would be made.

Looking at the product life cycle if firms operated on the neoclassical model, there would not be any investment in product development (see Figure 3). The expenses of the first five stages would have a negative impact on current quarter's profits and thus be working against the goal.

Organizations are looking at a number of longer-run goals and objectives that are at least multiperiod (several quarters long). It appears that the further an organization moves into the future, the more important the concept of product risk becomes. Many firms have recognized the importance of a multiperiod planning horizon but few United States firms are able to look at true long-range planning and goals.

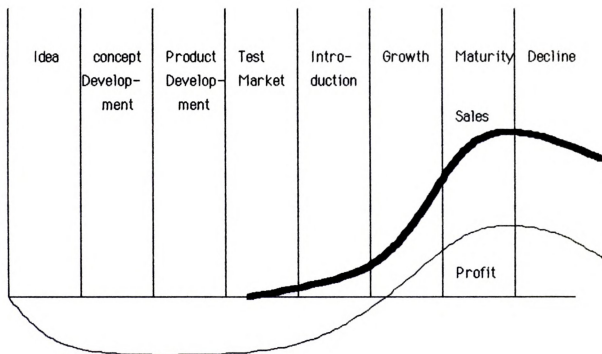


Figure 3

EXTENDED PRODUCT LIFE CYCLE

The tools do not exist within the disciplines.

There are at least four models that involve multiperiod goals.

1. Finance Model – maximization of shareholders
2. Customer Based Model
3. Agency Cost Model
4. Satisficing

The financial model is based on the maximization of shareholder wealth. It is often called the market value model (Anderson, p. 17) and is interpreted to mean maximizing the price of a firm's stock. The concept has been applied in marketing to product portfolio decisions (Cardozo and Smith). It involves assessing the net present value of all investments on a risk adjusted basis or using the capital asset pricing model (Harrington). The risk adjustment is based on the historical covariance of total investment return to a standard such as the market. There are two primary components that impact what an investor will pay for a security. They are risk and return. Marketing schemes have failed to make the distinction between these two which is essential to finance (Wensley, p. 173). Risk and volatility can be a function of individual projects or of the financial markets. One of the benefits of the financial model is that it forces marketing decisions to be evaluated as investments.

The corresponding disadvantage is that each project gets quantified and evaluated on its own investment, return and, hopefully, risk. Unfortunately, marketers have not developed the product market concept that addresses some of the uncertainty in future periods. There is a tendency to forget about the combined effects of projects leading to competitive advantage (Wensley, p. 178). This problem becomes

particularly acute as the planning horizons stretch out into the future when the importance of establishing competitive advantage may provide more stable returns than other projects (Kotler *et al.*, 1985). To quantify the return for the project is to ignore the potential of the firm to shape the product market and thus create greater stability. Conceivably, the goal of shareholder wealth is best served by a longer-term view which would focus on understanding the tradeoff between earnings and product market risk. Implicit in this line of reasoning is the assumption that success in reducing product market risk, as demonstrated by some measure such as presence, will lead to success in the financial markets. There has been established a link between customer satisfaction and profits (return) (Pickle, 1973). What is needed is to establish a link between customer satisfaction and variability of return.

The customer-based model emphasizes the development and marketing of products designed to fill customers' needs. It is, in short, the marketing concept that has been pushed by many authors (Levitt, Kotler, Pickle *et al.*).

Marketing concept: anticipating and satisfying customer needs and wants at a profit (Kotler *et al.*, p. 78).

The real question is how do returns vary with risk? Under the neoclassical model, profits are focused on immediately. In the market value model, the focus is a longer horizon to allow investments to convert to quantifiable returns. In the marketing concept the profits may be expected at a much later date.

... "The only way that one business firm can outmaneuver and defeat another is to create and sustain competitive advantage (Ibid p. 246)

The profits obtained through the marketing concept strategy may be far greater with less risk. Therefore the ultimate value to shareholders may be greater because of both the higher return and the lower risk.

Another model for goals to be discussed is the agency cost model. This recognizes the separation of ownership and control between the shareholders and management. It leads to suboptimization because some of the resources are invested in providing monitoring and providing incentives to management (Anderson, p. 17). This is a more realistic view for large firms with professional management. Using the agency cost model does not preclude focus on market value or the marketing concept.

A final model that impacts goals is Simon's theory of satisficing, in which management recognizes the complexity of calculation and the imperfections of the data which lead to problems in attempted maximization (Simon, 1959, p. 255). Firms elect instead to set themselves up for some minimal standards of achievement which, it is hoped, will lead to viability. As in the agency model, which is a derivative of satisficing, management could use both product market return and risk measures. It could be that if a firm is satisficing, the concept of focusing on product risk would be extremely important. The maintenance of presence would mean more security and therefore a better chance of survival.

One of the problems in strategic plans is that functional areas may see different goals at the top. For example, marketing could use market share, return on investment, competitive advantage, profitability, while finance could use financial market value, profitability, and so on. What is needed to bring the groups together is a superordinate goal (Kanter, p. 261;

Kotler *et al*, p. 256), one that all functional areas can agree on and focus their efforts on. One such goal might be to maximize profits at the lowest possible risk, including, in particular, product market risk. This would allow applying the same standard in the resource market and in the product market. This is dependent on marketing developing the product market risk concept and measures of risk.

Product Market Risk and Related Marketing Concept

There are a number of areas of exploration that are directly related to the environment and help with the understanding of product market risk. These include entrepreneurship, environmental molding and shaping, and time space occupancy.

Entrepreneurship

The entrepreneur shifts economic resources out of an area of lower and into an area of higher productivity and greater yield. (J. B. Say, in Drucker, 1985, p. 21)

The concept of entrepreneurship has been a part of the Austrian Economist School for a long time. It has only recently gained popularity in the more popular press (Drucker, Kanter, Kotler). von Mises, an Austrian, expressed himself quite clearly on numerous occasions to the effect that the entrepreneurial is inseparable from speculation with respect to uncertain future (von Mises in Kirzner, 1982, p. 139).

The notion that the entrepreneur is dealing with an uncertain future is very important to marketing, in particular, to product market risk. Marketers should not be building theory on the traditional microeconomic demand supply equilibrium model since much of marketing is aimed at

change.

This does not mean marketers should discard the important lessons learned from equilibrium theory. The process of change, initiated by the entrepreneur, can be thought of as moving the system towards equilibrium (IBID, p. 119, Pascour in Kirzner, 1982, pp. 217-218), a perfect state of affairs "...in which further changes are unnecessary or even impossible," (Kirzner, 1982 p. 112). It is the "... grasping of opportunities that have somehow escaped notice," (IBID). Advances are usually increases in efficiency in time, money, or space utilization.

Building on the earlier discussion of ignorance, partial ignorance, uncertainty and risk, the entrepreneur is a moving force, creating or perceiving structure where none was seen before. The entrepreneur moves ideas out of ignorance and into uncertainty or possibly risk. His rewards are based on the residual (Knight, p. 278) after all other material and labor are paid for at their known prices. Both the laborer and the entrepreneur are considered labor in the macro economic model.

The entrepreneur is successful because his creation or perception of structure has allowed the introduction of new products and new ways of making old products (Lipsey, p. 51). Success comes from reorganizing the factors of production and directing them along new lines (IBID). It is unquestionable that the entrepreneurs activities effect an enormous savings to society vastly increasing the efficiency of economic production (Knight P.278).

One of the important concepts to understanding change is the recognition that it is better understood over the longer run or multi time period as the changes often appear more obvious. This is seen in the study

of entrepreneurship (Kirzner, 1982, p. 113; Kotler, *et al*, 1975, p. 214). As Jack High stated, "Entrepreneurship usually implies anticipating the future" (High, in Kirzner, 1982 p. 164). Anticipating the future involves understanding uncertainty and therefore is directly related to product market risk.

Kirzner goes even further, suggesting that entrepreneurs construct the future by their own actions (1982, pp. 154-155). This is not such a different idea than the idea advanced by Robinson and Chamberlain where the future market is, in a sense, created by achieving monopoly. However, it does distinctly speak to the future.

Drucker, picking up on Say's original definition, defines the entrepreneur as one who shifts resources from areas of low productivity and yield to areas of higher productivity and yield. He adds the all important concept of risk. It is the risk of what an entrepreneur is attempting to do that severely impacts how outsiders evaluate what the entrepreneur is doing. The risk and value are affected by the time frame that the evaluation comprehends. Most entrepreneurial efforts of consequence require a longer run view of planning and return. This is a problem in the United States economy where the orientation is to the quarterly report. Kotler *et al*, speak of the success of the Japanese because of their long run view of return for entrepreneurialism in the product markets (Kotler, 1985, p. 214). Drucker advises not mixing managerial units: it is important to separate the entrepreneurial objective of innovation from management charged with running, exploiting, and optimizing what already exists (Drucker, 1985 p. 174).

In summary, Kotler states that entrepreneurship requires future

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strategy making in the "context of information and intelligence gathering analysis and use" (Kotler, 1985, p. 213). Entrepreneurship attempts to understand or quantify uncertainty. It deals in product market risk. The entrepreneur deals in risk as change is introduced. The concept of product market risk can be enriched by further study of entrepreneurship.

Environmental Molding or Shaping

Environmental molding and shaping is another area that may contribute to the advancement of product market risk. One view of the environment in which marketers operate is essentially reactive. This is the view that companies should be market driven by the customers--their wants and needs (Drucker, 1985 p. 252). This view is particularly relevant to the short-term view of marketing and strategic planning. Selection of segments based on demography, geography, income brackets, and other current or historical data would be an illustration (Anderson, p. 186) of responding to the existing product market environment. Many of the models currently used, such as those based on the share and growth (Boston Consulting Group, PLC), current shopping behavior (classification of good), current markets (Product Market Matrix), and so forth are reactive to the environment.

A wholly different view is the idea that the market can be shaped or molded for the future by the market participants as expressed by Wensley:

"...the explicit recognition [is] that today's strategy is tomorrow's history and therefore, the strategic decisions of today are shaping the strengths and weaknesses of tomorrow. (Wensley, p. 181)

The intentional use of today's strategy to change tomorrow's market environment and thus enhance the position of the firm in the future should

be a part of long term strategic planning. Firms may help customers to appreciate the particular benefits that their products have and thus differentiate the products and the way they are sold.

Product differentiation is an attempt to discover, as well as to modify, consumer preferences; and this is a two way process because consumers often need to discover what the relevant part of their own preference function is. (Loasby, p. 185)

Drucker talks about shaping the product market environment under the topic of innovation. He suggests that demand can be changed by altering the value and satisfaction that consumers receive (Drucker, p. 33). Shaping the product market may well reduce risk; the goal may be presence.

The concept of investing in molding the future environment in which a firm will compete is directly related to achieving greater stability on the product market and is a long term strategy. When the Japanese accepted voluntary import quotas, it allowed them to create artificial shortages in their economy class cars and thus provided the opportunity of increasing price and profits while upgrading the image of the car in the United States market.

Presence, as has been noted, is a condition of low product market risk in current markets that can be carried over into markets of the future. Efforts at molding or shaping the competitive environment in the product marketplace are certainly an essential part of any long term strategy to develop presence. Environmental molding is the planned use of marketing investments to disrupt the product market place to effect a positive long term change in favor of the firm's products by consumers.

A Time Space Perspective

Time, space, and culture permeate both the product market and the financial side of understanding what firms are attempting in their quest for competitive advantage.

In the product markets, the occupation of time and space can lead to competitive advantage and presence. Economists (Pred) have recognized that customers have time constraints as well as a wealth constraint. Thus, a brand can reduce product market risk by providing better benefit values or by creating barriers to entry by occupying time or space. Occupation or savings of time and space can provide a firm with the opportunity for presence.

The opportunity cost of time is important to the use of time in gaining competitive advantage. Time is used in at least the three following ways for each purchase: (1) time in acquisition, (2) time in consumption, and (3) time in disposal.

The entrepreneur who recognizes the opportunity for change in any area of time may be able to create a positive disruption and therefore create stability for their products. Some examples include: in acquisition, McDonalds; in consumption, Lean Cuisine; in disposal, Pampers.

This point is emphasized by Scharry, who refers to consumption as the production of satisfaction whose inputs are time and money (Scharry,). There are a number of ways in which time and space can be used to create low product market risk, presence. They form important elements in the customer perceptions of standards.

Conclusion

Marketing has developed many models and measures to help with strategic planning but it has not addressed product market risk in the literature in the conceptual way that finance has explored risk. Uncertainty is implicit in most of what is done in the product markets. If quantified into risk measures it could help relate all strategic planning in both the resource and financial markets. The issue of product market risk and the financial market is covered in the chapter three. The marketing literature offers little in the way of product market risk discussion to address the questions posed in chapter one.

Of the four questions posed at the end of chapter one, two of them (questions two and three) have been addressed in the marketing literature.

1. What is the relationship between stockholders objectives and firms objectives?
3. What are the needs for a marketing based product market risk measure?

The remaining two questions (two and three) will be addressed in chapter three.

2. What is the relationship of product market risk to the financial markets?
4. Can evaluation be explained solely by traditional measures?

CHAPTER THREE

REVIEW OF FINANCE LITERATURE

The assumption was made that those interested in investing resources should be interested in the potential risk and future returns from the product market. The research questions in chapter one are directed at the validity of this assumption and the determination of methods and extent of consideration of product market risk factors in the financial evaluation process.

As background, for the development of this exploratory work, several related areas in finance have been reviewed, namely: efficient market theory, macromarket importance, valuation methods, and analysts' roles.

Efficient Market Theory

The efficient market according to Fama is, "A market in which prices fully reflect available information..."(Fama, 1970, p. 383). Thus, any information about a firm should immediately be reflected in the firm's price on the equity markets (Stiglitz, Rosenberg, Treynor, 1976). Market efficiency is important to the questions of need for product market risk information.

What works well in the inefficient model does not necessarily work well in the efficient market; for example, basic analysis tends to produce consensus reasoning about the qualities and value of the firm (Rosenberg,

Product Market Competition and the Value of a Patent

The first problem was raised by those who argued that the patent system is not efficient in the presence of product market competition. The basic idea is that the patent system is designed to create a monopoly and the patent holder is expected to use this monopoly to the extent of the product market. If the product market is competitive, the patent holder is expected to use the patent to the extent of the product market. This is the basic idea of the patent system.

As we pointed out in the introduction of the article, the patent system is designed to create a monopoly and the patent holder is expected to use this monopoly to the extent of the product market. If the product market is competitive, the patent holder is expected to use the patent to the extent of the product market. This is the basic idea of the patent system.

Product Market Competition

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What would be the effect of product market competition on the value of a patent? The basic idea is that the patent system is designed to create a monopoly and the patent holder is expected to use this monopoly to the extent of the product market. If the product market is competitive, the patent holder is expected to use the patent to the extent of the product market. This is the basic idea of the patent system.

p. 43). This is not to suggest that some fundamental analysis of the firm is not important but that the investor or the analyst who wishes to out-perform the market needs to do more extensive research. The analysts who base their research on the published statements can only end up with the consensus position unless unpublished information or assumption has been used. This may be all that is possible if the market is truly efficient.

Treynor (1976, p.50) suggested:

When one talks about market efficiency it is important to distinguish between ideas whose implications are obvious and consequently travel quickly and ideas that require reflection, judgment and special expertise for their evaluation and consequently travel slowly. The second idea rather than the obvious quickly discounted insight relates to "long-term" business developments--is the only meaningful basis for the long-term investor.

The efficiency of the market, therefore, is closely related to the efficiency of the analysts in understanding or interpreting new information or rumor. In cases where there is special information about developments in the product markets, company spokespersons may have to attempt to communicate to analysts, in as simple a manner as possible, so that the market can promptly adjust the price (value) to fully reflect the information.

If the strong form of the efficient market theory is accepted, "then a security's price will be a good estimate of its value," (Sharpe, 1981, p. 72). The market price of a security should always reflect fully all knowledge about the security and the company. In the semi-strong form all publicly available information is reflected in the price, therefore fundamental analysis based on published statements would not generate

any advantage. The weak form of the efficient market theory allows for some variation in use of information. In this form, a large number of educated investors exploit similar information in valuing securities (Rosenberg, 1982, p. 48), but do not always reach the same conclusions. The variant opinions published by reputable analysts would indicate this form best describes the financial market.

The efficient market theory is important to understanding the way that analysts use information and the extent to which they trust the financial market to be an efficient reflector of information. Investors and analysts have learned that the inefficient market requires research. Methods not needed in the efficient market (Rosenberg, 1982, p. 43). Analysts should, therefore, be concerned with the inefficiencies and the lack of ready availability of either risk or return information from particular projects in the product markets (Brealey, p.166).

Macro Models

Macro models are important in financial analysis because of the dominance that macroeconomic expectations could have on expected levels of return for any given level of risk. This is particularly true for organizations using the top down approach: forecasts are made first for the economy, next for the industry, and finally for the firm.

The use of macroeconomic data is obviously important in trying to make estimates for valuation in any top down approach. Despite the importance of its use there has been limited success in developing predictive macro economic models and linking them to expected results for individual firms (Rosenberg, 1982, p. 47; Eckel, 1982, p. 68). This may

be because there are pieces of information not currently involved in the models. Information, such as product market risk or a measure of presence of the firm in the product markets in which it competes, might help make the model more accurate.

Valuation of Securities

The valuation techniques discussed here are essential to understanding the market research process and in determining to what extent this system considers product market risk, or some measure such as presence that indicates risk, in its valuation system. The test for its existence was conducted among financial analysts.

The view of investment research as appraisal (Rosenberg, 1982, p. 43), is the heart of what makes the financial markets work. Analysts are always looking for some inefficiency in the financial markets, some new piece of information not previously considered, that will give a firm basis to a non-consensus position.

Most frequently used valuation models are:

1. Capital Asset Pricing Model (CAPM)
2. Cash Flow Models
 - Dividend Growth
 - Earnings Growth
 - Present Value of Discounted Flow
3. Security Price Based Models
 - Price to Earnings
 - Price Earnings Relative
 - Price to Sales
4. Book Value

Capital Asset Pricing Model

The capital asset pricing model, CAPM (Sharpe, 1970), is based on the concept of beta, a relative volatility measure. It assumes that capital markets are influenced by risk-averse investors and therefore security returns must incorporate a risk premium (Goodman and Peavy, 1983, p. 61). It is this risk aversion and compensating risk premium that are the focus of attention. If a measure in the product markets carries some indication of changing risk, reduced or increased, to the securities market then, the change in risk should be promptly reflected in the financial market valuation.

Beta volatility refers not to earnings alone but rather to how the total security return covaries with the market of securities. Beta is a function of changes in price and dividends of the stock, and price and dividends of the market over time. Most betas are historic, being based on a five or ten year period. There is no future component in this security pricing methodology. The historic nature of beta implies certain limitations.

1. **Historical Focus**
Beta is a historical measure and therefore has no component of expectation except continued covariance with the market.
2. **Beta and Potential Benefits**
Beta is not designed to reflect the potential benefits of product market molding and shaping which may not be recognized by financial analysts until some results are seen.
3. **Beta and Risk**
Beta is an indicator of corporate risk -- or business and financial risk rather than a direct link to product market risk.

While beta is a good and useful tool it does not answer any of the

questions about how product market risk or investment is perceived in the financial markets. Its historical orientation limits its use as a future predictor if changes in the product market environment are occurring.

There are attempts to make beta a better indicator of the future. Some firms use an adjusted beta formula which pushes high betas down and low betas up, moving all betas toward an average market return in the future (Brealey, p. 172). Rosenberg has questioned the use of historical data and shows that it is possible to develop a method that allows betas to vary over time (Rosenberg, 1973, p. 331). The problem of the future being unknown remains, and betas can only act as an imperfect guide (Brealey, 1984, p. 167).

Presence may not be reflected in higher reported earnings and recognized increased stability (lower risk) for several years. These elements will then be reflected in beta. Since presence as an indicator of low product market risk is a future based measure and beta is historically based, it is possible for the risk to be increasing by the time beta has recognized the earlier strength.

The product markets are future oriented. The information content of risk in the product market place may be an important complement to sophisticated earnings and market based measures such as beta.

Beta is measuring two kinds of risk: business risk and financial risk. Business risk is a function of the firms operations.

Business risk $f(\text{firm operations})$

This would include but not be limited to the following:

1. Market Share Position in the Product Markets
2. Management Policies

3. Economic Conditions
4. Labor Relations
5. Product Liability
6. Control of Cost
7. Research and Development
8. Relationship with Channel Members
 - a. Suppliers
 - b. Distributors
9. Current Customers Demand
10. Quality Control

Note that these items are important in the neoclassical approach to maximizing period profits with the exception of the one marketing investment: research and development. In sum, business risks are those things that contribute to variations in earnings before interest and taxes (EBIT). Business risk is sometimes called operating risk (Haly and Schall, 1979).

The concept of business risk assumes a more managerial orientation in pursuing business in a stable environment. Basically it assumes continued operations of the product markets in the same fashion. It does not conceptually encompass the reshaping of the product market by introduction of new product space, (Sony Walkman, swimmer watches, handheld calculators), or an environmental change (microwave, energy cost, deregulation), a new substitute, (hair mousse, aspartame, health maintenance organizations), and social change, (reduced alcohol consumption, health consciousness, two-income families). While these risks are large, they are not those that are inherent in the firm's operations, but rather in the product markets.

Financial risk, in contrast to business risk, refers to the firm's ability to meet its financial obligations. These include but are not limited to such items as:

1. Interest on borrowed funds
2. Current obligations from operations
3. Current portions of long term debt
4. Preferred dividends
5. Historic level of common dividends
(some companies have a no dividend policy)

Financial risk is essentially a balance sheet phenomenon. It does not incorporate any current product market information except sales. The product market is only reflected in how sales have impacted the income statements, and therefore the balance sheet. The balance sheet can certainly be affected by other things through wise use of financial knowledge. Decisions to use different financing methods may be impacted by the financial community's impression of what will happen in the product markets. For example, if success in the product market seems imminent, then sophisticated investors may be willing to pay more for stock (Simmonds, p.1), or buy more stock, allowing the company to use new equity instead of debt financing.

Business risk and financial risk both are part of the total risk that beta is measuring. Neither of the components is directly product market oriented. Inherent in using beta is the problem of the lack of specificity addressing the product market risk. The CAPM using beta was not constructed to reflect major future changes in product markets as would be indicated by a low product market risk or presence. This is because of

the lack of an available measure for direct input from the product markets.

The CAPM is a credible tool in finance and was a significant advance as it recognized financial market risk along with business risk. What is ultimately needed is a measure of product market risk that could be used along with CAPM by the financial community for better evaluation relative to risk and return.

Cash Flow Models

The cash flow models are much used in practice because of their relative simplicity and flexibility. The most popular cash flow model is the discounted cash flow. Usually the estimated cash flows are discounted for a period of five years. In this model the estimate of return is handled in the cash flow and the estimate of risk is handled in the rate of interest used to calculate the discount. The rate of interest is frequently chosen by the current cost of capital for the firm as opposed to the riskiness of the project. Thus, there is no direct input for product market risk.

Dividend Payout Model

The dividend payout model is based on the assumption that managers will continue to pay out dividends at some rate of growth (Lintner, 1956). Implicit is the assumption that management can maintain its current relative growth rate (and rate of market investment), and that the product markets will continue a stable growth path. The price of stock is a function of dividends and dividend growth rates:

$$P = \frac{D}{r - (D+G_1)}$$

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The dividend model is based on a stable market assumption and a managerial focus. It is not responsive to environmental modeling and shaping or of incorporating the results of marketing investment leading to reduced risk in the product market.

The basic formula with no growth:

$$\text{Price} = \frac{\text{Dividend}}{\text{Capitalization Rate}}$$

$$\text{or } P_0 = \frac{d_1}{K_S}$$

Constant growth rate:

$$P_0 = \frac{d_1}{K_S - g}$$

Period of super normal growth:

$$P_0 = \sum_{t=1}^n \frac{d_0(1+g_S)^t}{(1+K_S)^t} + \frac{(d_n+1)}{(K_S - g_n)} + \frac{(1)}{(1+K_S)^n}$$

Here period "N" is the period of super normal growth, g_S is the supernormal growth rate, and the normal growth rate is " g_n " (Weston and Brigham p. 648, 1978). This reflects a company in the growth portion of the product life cycle leveling to a normal growth rate in a later period.

Dividend growth models and earnings models are usually based on pure extrapolation of earnings and dividends. These historical approaches are not responsive to changes in the product markets until such changes have been reflected in sales and sales have passed through to earnings and earnings to dividends.

Earnings Growth Model

The earnings growth model is very similar to the dividend payout model except all of the calculations are based on reported earnings. Like the dividend growth model it is not reflective of changes in the product market until they impact sales and income statements. Marketing investment would reduce earnings (expensed). Long term market investments could have a particularly negative effect because the improvement of sales might not show up in earnings for several periods and thus could focus attention on lower earnings instead of the increased investment.

Present Value of Discounted Cash Flow

This method requires a projection of the present value of future cash flows (usually an extrapolation of present sales) and is cash flow oriented (depreciation is added back) instead of earnings oriented. While the future projections help remove the problem of the historical basis, it depends critically on the forecast of cash flows and on the discount rate applied (Rosenberg, p. 43). In reality, since cash flow estimates are rarely based on customer information they are either estimates or an extrapolation of historical information. It is believed that a customer based measure would give a more informed judgment. While the historical method is useful it does not recognize product market risk, or how much uncertainty has been or can be removed by strategic marketing investment.

Treynor (1972, p. 43) has issued another challenge to the earnings based models:

Current methods of security valuation depend on treating earnings as if they were economic rents.

Far from being rents, however, accounting earnings are more like estimates of change in the value of the firm over the accounting period--if indeed they have any economic meaning at all. If this is the meaning of accounting earnings, however, then their use in estimating the value of the firm is circular; the analyst will have to face the fact that he actually lacks any defensible basis for valuation methods based on earnings and start looking for methods with a plausible basis. (Treyner, 1972, p. 43)

Price Based Models

These models are all ratios based on the price of stock. Since the financial market is future oriented, the price of the stock is the financial market consensus view of future value at any one time. The consensus is continually moving and, therefore, so is the price of the stock. These are the most future oriented measures available because it is the consensus of people who are always looking to future investment horizons.

The P/E ratio presumably represents investors' collective opinion regarding a firm's future prospects and its riskiness. (Goodman and Peavey, 1983, p. 60)

The price earnings ratio (P/E) can change because of: (1) change in price (applicable discount rate), and (2) change in earnings.

Changes in earnings that are not perceived as permanent only change earnings; a temporary increase in earnings would only lower the P/E ratio. If an earnings change is perceived as permanent then the price of the security will change. If the earnings change is transitory there should be no change in price (Sharpe, 1981, p. 397). Potential for permanent changes in earnings may be recognized before they show up in reported statements and thus change P/E ratios.

P/E is ultimately related to earnings. The "E" is related to reported

earnings (that have been earned). The P is related to projected earnings based on a consensus of related risk. Thus, if financial investors perceive a value in market investment that has not been recognized in the historical statements of the company, it will be reflected in the P/E with a higher price. Conversely, if investors see changes in the market environment that may have a negative impact on earnings, it will be reflected in the P/E with a lower price. There is the implication that the P/E ratio can be used as a partial predictor of future earnings (Malkiel and Cragg, p. 616). Stocks with a low asset base and a high P/E reflect investors' anticipation of steadily increasing profit levels in the future.

A strategy developed from the P/E ratio that has received some credibility in the academic and applied communities is the low P/E investment strategy. The argument is that a higher than market rate of return can be generated (Goodman and Peavey, 1983, p. 61). The reasoning is that downward momentum (an inefficiency) has depressed the prices of those out-of-favor stocks lower than they should be.

A second price level based ratio is the PER or price earnings relative.

The PER is expressed as follows:

$$PER = PE_i / PE_I$$

Where:

PE_i = the price-earnings ratio for security i

and,

PE_I = the mean price-earnings ratio for the related industry group....

The PER is an index of the P/E ratio of a stock relative to that of its industry. A PER of 1.0 indicates that the stock's P/E is typical of its industry average. (Goodman and Peavey, 1983, p. 61)

The third price based ratio is price to sales. It is per share price relative to per share sales instead of per share earnings (Fischer, 1984, p. 37). Stated another way, it is the total market value of the company

divided by the last twelve months corporate sales. Sales are much more directly related to the product market than are earnings but they retain the disadvantage of being historically oriented.

Book Value

The fourth type of valuation model to be considered is the book value method. This method of valuation (net assets minus liabilities) is calculated by using balance sheet figures (Harrington and Wilson, p.125). There is, naturally, a heavy dependence on physical assets at their depreciated value. The book value method is even further removed from the product markets than the earnings method, as accounting practices may be manipulated to affect book value.

Book value ignores intangible assets such as, competitive advantage (Coyne), technology, market position, copyrights, trademarks, patents, franchise licenses, and contracts. It ignores the appreciation of real property. It ignores all risk.

The book value method provides no direct product market evaluation and is completely historical. It only reflects behavioral events, the value at the time of entry on the corporation's books. Therefore, it does not incorporate product market risk.

In summary, three of the basic types of valuation, CAPM, cash flow models, and book value, are all behavioral based and therefore do not reflect current product market investment, risk, or the development of presence in the market place. More future oriented measures are needed for publicly traded firms to complement the historically-based and the priced-based measures. The P/E ratio is the most current measure

available. It communicates how strongly investors feel about the future of the particular security. The P/E is best used in comparison to the industry (PER), or the market. The relative size of the P/E may indicate to what extent investors feel that there is a marketing investment process going on (lowering current earnings but raising future expectations due to lower risk or higher return expectations) and whether it is likely to lead to achieving the marketing objectives.

Marketing Investment and the Cost of Capital

Success in the financial markets is related to success in the product markets. The cost of capital for a firm is derived from the accounting earnings and the risk of the return. One of the problems is that this generally does not take product market risk into account. Presence is thought to be derived from successful market investments that have led to positive disruptions in the product market and a high level of acceptance of brands in current markets that will carry over to brand positions in markets of the future. Thus, presence indicates a low product market risk.

The capital for a firm may come from a number of different sources: debt and equity and an assortment of equity/debt combinations. All of these contribute to the cost of capital. However, for this discussion cost of capital will be confined to the cost of equity capital, common stock.

A simplified view of the equity markets shows that prices are affected by:

1. Earnings Stream
2. Assumed Liquidating Dividend
3. Volatility--risk of earnings stream

4. How the security return covaries with the market

Managers need to reflect on the two major ways in which marketing investment decisions impact earnings volatility and therefore cost of capital.

1. At the time of the marketing investment(s) there are reduced earnings (marketing investments are expensed: Fruhan, 1979, p. 55). This negatively impacts earnings in the current period and may also negatively impact volatility, both short term factors.
2. If marketing investments are successful then the earnings and stability of those earnings should increase. This necessitates a longer range inter relation of market investment planning and financial requirement projections to assure that timing allows for the maturation of marketing investments and resulting earnings increase coincident with new capital requirements. Under current evaluation systems this should result in the lowest cost of capital.

The marketing investment decision then has to be considered in light of its potential return because of impact in the product markets, and also its impact on earnings, volatility, and ultimately the cost of capital or the value of the firm (Simmonds, p.1). The focus on financial statements and current earnings serves to ignore the impact of any market investment in the product markets. A firm with low product market risk should be in a stable income producing product market position and have the potential for for growth. Therefore, because of the higher potential earnings and greater stability, short term and long term, the firm's cost of capital should be lower than that for a firm in a riskier product market environment.

A structured market investment program leading to decreased risk and increased sales should not only increase operating earnings but also lower the cost of capital and thus further increase reported earnings.

Marketing management can help keep their own opportunities greater if their directional choices are considered in light of their ultimate impact on the cost of capital. This requires a holistic view of the relationship between the product and capital markets and an appreciation for the timing in these markets. In addition it should be recognized that, in general, individual investors are also customers and are influenced in their investment of funds in the resource markets by their perceptions of product market risk as impacted by current market investment strategies.

While it seems apparent that many investors and financial analysts are considering product market risk implicitly in their valuation of securities, marketers should pursue a more direct understanding of the effects of present and future risks in their product market areas. Management needs tools, models, and methodology for including these concepts in their working information.

Marketing is the interface with the product markets. Finance is the interface in the financial or capital portion of the resource markets. Unfortunately in the United States neither finance nor marketing have a way of evaluating long term product market investments. This tends to focus the attention of management on more short term strategies in the product markets.

Management needs to be able to draw the links directly between long term market investments to reduce product market risk and the impact of reduced cost of capital because of earnings and stability. The explanation of these relationships is important to the further development of the concept of presence. It was conceived of as a risk performance measure and therefore should be directly related to the cost of capital.

Analyst Role

The cost of capital is directly related to the consensus of the market as indicated by price for any given level of perceived risk. The consensus of the market is often influenced by the analysts who are influencing the major portfolio managers at large institutions. According to Hagaman and Jensen, analysts review large amounts of information but:

...only five basic factors enter into his reckoning of investment value:

1. the amount of common equity currently employed;
2. the rate of return required to compensate for risk;
3. the rate of return earned on capital employed;
4. the amount of additional capital to be employed in the future;
5. the investment horizon--the period during which returns on capital employed will exceed the required rate of return...(Hagaman and Jensen, p. 63).

Given the efficiencies of the financial market it has been assumed that quantitative information will be promptly translated into a financial market price, appropriate for the risk level. Qualitative information may provide more opportunity for the analysts. If analysts can gain insight and reduce or increase their assessment of risk then the price can be recalculated for the new risk level. It is essential, for this to have any effect, that an analyst emphasize methodology, skills, or insights not possessed by others (Rosenberg, 1982, p. 49.). Thus, there is a need for something between the subjectivity and market psychology of the individual analysts and the more structured formula approach which tends to work from available quantitative data (Treynor and Black, 1973, p. 66).

Conclusion

There are many areas of finance impacted by product market risk. Looking at the model of a market directed economy (see Figure 2, McCarthy, 1984, p. 17), the separation of firms' (producers) product markets, customers, and resource markets is clear. In this model resources are being traded for other resources or services. Financial theory focuses on risk and return in one portion of the resource market, the flow of funds. product market risk focuses on the risk of the firm in the product market.

Financial theory considers two risk areas: financial risk and business risk. Financial risk deals with the risk to the capital providers in the form of debt and equity. Business risk deals with most other risks, trying to recognize some risks from other parts of the macroeconomic model such as:

- Product market
 - Market share
 - Consumer demand
- Customers
 - Labor relations
- Government
 - Economic conditions
 - Regulation

It is time that theory advanced to the point of recognizing and developing measures for other major components of risk in the macro model. The product market, as the source of the earnings stream, represents an important area of risk and deserves the attention of the financial and marketing disciplines. A measure of presence is conceived of as an indicator of low risk in the product market relating the customers to the strategic business units of the firm. The development of an

understanding of product market risk and presence, could enable the product markets to become more efficient much as the research on risk in finance has improved the efficiency of the financial markets. The financial markets have developed many hedges against risk which increases its efficiency. To move in this direction a measure of the degree of product market risk would be necessary. A better understanding of the role of product market risk is the first step toward a more complete understanding.

CHAPTER FOUR

METHODOLOGY

Introduction

The need for a product market risk measure in the disciplines of marketing and finance has been discussed. Before a measure can be developed, it is necessary to develop the constructs and theories that can lead to measurement development. These need to be consistent with existent theory in both disciplines and pragmatically they should be consistent with present behavior. Ideally theoretical constructs should be based on observable constructs which are isomorphic with theory. This study focuses on observing current behavior: what do analysts do, and attempts to relate the findings to presence and product market risk in both marketing and financial theory.

Inductivist Approach

As was mentioned above in chapter one the research process is one of induction. The literature reviews in marketing and finance serve as an extensive situation analysis which guided the researcher in observation. In particular: what, who, how, and when to ask in order to maximize the efficiency of observation.

The inductive process is viewed in a similar way by several authors, Hunt (pp. 18-19) shows a diagram that begins with observation, moves to recording data, then classification, and finally the induction of generalizations. McGarry (p. 84) notes that the scientific method in marketing involves the following four steps: (1) selection of facts, (2) registration of the facts, (3) rearrangement of the facts to bring order out of chaos, and (4) finding a formula or conclusion. Dubin discusses description or reporting: (1) asking questions as opposed to testing hypothesis, (2) empirical research, and (3) drawing inference from outcome.

The process used in this research is: (1) observation, described in chapter four, (2) processing of facts as seen in chapter five, (3) development of a classification scheme as seen in chapter six, (4) development of generalizations and applications for product market risk and presence as can be seen in chapter seven, and (5) suggestions for future research in the area of product market risk, presence, and the model as seen in the future directions section of chapter seven.

It is important to remember that the research questions are not part of a logic of deduction but represent areas for observation in the process of induction.

Rationale

The research questions were explored using data collected from individual interviews of financial analysts and money managers in Chicago, Detroit, Kalamazoo, New York City, and Stamford. The rationale for using this particular population and method to collect data, along with a description of the procedure used, are presented in the following

discussion.

Development of a new concept requires exploration. The aim of this research is to understand better a phenomenon and the theory surrounding it. At its early stage of development, more understanding and insight into the complex and subtle aspects of the relationship of product markets and financial markets and the importance of product market risk in them can be gained from a qualitative study. This decision was made based on the lack of specific terminology in either marketing or finance that dealt with product market risk. It would be expected that among practitioners product market risk would be found before presence. In addition to looking at the research questions it was necessary to become familiar with the terminology used in application to see if there were terms already covering product market risk.

The research was conceived as aiming at what Bonoma called drift.

...learning the locale and jargon of the phenomena
as it occurs 'in the field'...a soaking stage in
which contexts are observed to get a better
perspective on modification necessary to the basic
research question. (Bonoma, 1985, pp. 204-205)

It is important to gain more understanding of the context and how the phenomenon appears in the field.

The decision to focus on financial analysts was based on the literature, which indicated that the finance discipline has much more developed risk and return measures. Therefore, it was supposed that if any professional group would use in practice a product market risk measure or concept it would be the financial analysts.

This was further supported by the practitioners' claim to be investing for the future. Whether this is conceived as short or long term they must

1. The first part of the document is a letter from the

author to the editor of the journal, dated 1945.

2. The second part is a letter from the editor to the

author, dated 1946.

3. The third part is a letter from the author to the

editor, dated 1947.

4. The fourth part is a letter from the editor to the

author, dated 1948.

5. The fifth part is a letter from the author to the

editor, dated 1949.

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be looking beyond the behavioral measures in the product markets. They may be subjectively looking at the future and considering such elements as: (1) macro environment, (2) industry, (3) management strength, (4) technology, and (5) product market risk.

These do not provide concise quantifiable data like the more traditional measures or explanation like the traditional models, but may provide more insight into the future.

In trying to get answers to the research questions from financial analysts a number of different approaches were considered. All consideration had to be made within the known constraints:

1. Limited access to analysts
2. Busy schedules of analysts and difficulty in planning ahead
3. Location of analysts in major money centers
4. Hesitancy of analysts to share candidly with other analysts what they are doing
5. The lack of standardized terminology to cover the topics in the research questions
6. Expenses of the research project

Some of the possible ways of getting information from the analysts that were considered included surveys, focus groups and interviews. Surveys were excluded because of the unknown semantics of product market risk in the practitioners' world, and because it was presumed that there would be a very low response rate. Focus groups were excluded because several of the firms contacted were not interested in sharing information with other firms, and because of the difficulty and expense of gathering people in New York or Chicago. Additionally, there was a sense

that analysts would be inclined to gravitate to the center in a focus group as opposed to saying how they were really processing information. Interviews were selected as the medium for data collection because they would provide the analyst with maximum flexibility and privacy, therefore eliciting the most valid and reliable information. Each analyst was contacted through a superior such as the head of research in the firm who approved and, in every case, encouraged their participation in the study.

Sample

The sample is a convenience sample composed of analysts and portfolio managers from banks and brokerage firms. The sample was selected on the basis of personal contacts, location, industry and type of institution.

The sample was convenient because of the difficulty of contacting and getting interview time with some of Wall Street's primary analysts. These people are extremely busy and their time is valuable; an hour for an in-depth interview was asking more than was originally conceived. The sample was developed through a growing network of contacts, starting from three very different original sources. Several of the interviewees were interested enough in the study to specifically suggest additional subjects to be interviewed. This proved extremely helpful in getting to some of the top source people. Every effort was made after the pretest to obtain as many interviews as possible in the money center banks and brokerage houses as it appeared obvious that the regional banks and brokerage houses were obtaining all their information from these sources and processing it in different ways. Since the key to the success of any model or forecasting technique is the quality of the information, an effort

42.16%

1. The first step in the process of identifying a problem is to define the problem. This involves identifying the symptoms of the problem and determining the scope of the problem.

2. The second step is to identify the causes of the problem. This involves identifying the factors that are contributing to the problem and determining the underlying causes.

3. The third step is to develop a plan of action. This involves identifying the steps that need to be taken to solve the problem and determining the resources that will be needed.

4. The fourth step is to implement the plan. This involves putting the plan into action and monitoring the progress of the solution.

5. The fifth step is to evaluate the results. This involves assessing the effectiveness of the solution and determining whether the problem has been solved.

was made to get as close to the primary sources as possible.

The specific industry that analysts were following was considered to be very important. The study focused on three very different industries to attempt to provide inter-and intra-industry comparisons of how analysts obtained and processed information in the evaluation effort. These three industries were newspapers, ethical drugs, and computers. They were selected for difference in industries within the areas where access to analysts could be attained.

Even though the sample is small, every effort was made at this early stage to obtain a representative research base that would help develop an understanding of product market risk and the concept of presence. In summary, the sample was chosen for its location in money centers, particularly New York and Chicago, its industry representation, and for balance between banks and brokerage houses. Figure 4 shows the complete sample and their coded identification, the location of the office of the interviewee, self classification of the industries that the interviewee followed and the type of firm that employed the interviewee. It is worth noting that analysts were frequently recommended as following an industry, but then self classified themselves as generalist.

Personal Interviews

Interviews were selected because it was felt that they would offer the best opportunity to assess the use of product market information in the evaluation of securities. The exploratory nature of the work required that differing ways be sought out and examined to develop an improved conceptualization. As mentioned above, it was felt that surveys and even focus groups would pull the participants toward a mean, or center. Instead

<u>Analyst</u>	<u>Location</u>	<u>Industry</u>	<u>Bank/Brokerage</u>
A-1	Chicago	General	Mergers & Acquisitions
B-1	Detroit	General	Brokerage
C-1	Kalamazoo	General	Bank
D-1	Kalamazoo	General	Bank
D-2	Detroit	General	Bank
E-2	Chicago	General	Bank
F-1	New York	Newspapers	Brokerage
G-1	New York	Computer	Bank
G-2	New York	Drugs	Bank
G-3	New York	Newspapers	Bank
H-1	New York	Computer	Bank
H-2	New York	Newspapers	Bank
J-1	Detroit	General	Bank
J-2	Detroit	General	Bank
K-1	New York	Drugs	Brokerage
L-1	Stamford	Computer	Brokerage
M-1	Chicago	General	Bank
N-1	Chicago	Drugs	Brokerage
P-1	New York	Computer	Brokerage
M-2	Chicago	Manufacturing	Bank

Figure 4
SAMPLE LIST



of encouraging the development of new ideas and understanding the terms, groups or surveys would encourage participants to move away from their own thinking towards that proposed on the survey or in the focus group. At this stage the focus of attention was on looking for more ideas and insights.

To further enhance the individualness, each interview was conducted in the participant's own office or nearby facility at their organization. Participants had no specific knowledge in advance other than a letter confirming the appointment (see Figure 5) and a two-page synopsis of the study (see Figure 6). The specific questions were new to the interviewees at the time they were interviewed. This provided the study with the freshest possible insights at the time of the interview and as much of a "real world" context as was possible.

Interviews were also chosen because it was one way to assure the attention of these busy executives on the subject matter. In almost every case, the person making the appointment clearly set aside a block of time for uninterrupted work with the interviewer. This facilitated getting as many answers from each interviewee as possible and allowed the researcher to explore unclear points and pursue related areas of interest.

It is acknowledged that there are disadvantages to using the interview method. The researcher's bias, the inconsistency of answers and the time gaps between interviews have to be recognized. However, it is believed that for exploring a multidisciplinary concept with practitioners in finance, this was the most effective starting point.

October 9, 1985

Mr. John Smith
Senior Vice President and Group Executive
Bank
P.O. Box 844
Bigtown, IL 33333

Dear Mr. Smith:

In confirmation of our phone conversation, I will plan to meet you in your office on:

Tuesday, October 22, 1985 @ 1:00 p.m.

As we discussed, the interviews have been running forty-five minutes to one hour in length.

Enclosed for your information is a brief introduction to the research. The interview will be conducted from a prepared list of questions. The research process would be greatly enhanced if the interview could be taped for further analysis.

I appreciate your willingness to participate and I am looking forward to meeting with you.

Please don't hesitate to call if you have any further questions or concerns.

Cordially,

Paul M. Lane
(616) 383-1347

Enclosure

FIGURE 5
CONFIRMATION LETTER

Introduction

Managers in the United States have been accused of being shortsighted. The lack of long-term planning and market investment has been a focal point of the discussions about why the United State is having a difficult time competing with foreign competition, in particular the Japanese. The reason for this shortsightedness has been attributed to the reward systems for management. These tend to be based on accounting period-oriented measures such as profits and sales, and are, therefore, historical or current in orientation. They do not convey information about the future. The combination of the available measures and the tendency of United States managers to be committed to their career path rather than to the organization encourages a short-term orientation.

A new concept and additional measures are needed which indicate the long-term (three to five years) impact of today's actions. This would be useful in an investment perspective looking at how the value of market position has increased as a result of marketing action. Stated another way, how the firm's situation has improved in the product market, which would indicate a stronger carryover into the unknown situation of the future, is one of the phenomena that has to be operationalized to help improve and develop a longer term orientation of the measurement and reward system.

The key to marketing is the satisfaction of consumers, therefore the carryover phenomenon and the measures associated with it should focus on the perceptual framework of the consumer. Consumers' perceptions determine the acceptance of brands in current markets and influence future acceptance. Before new measures can be developed, a better

understanding of the phenomenon is needed.

The condition which describes how the acceptance of brands in current markets carries over (or can be carried over) to existing and new offerings in future markets is defined as "presence" in this dissertation. The concept implies less volatility in the unknown future of the product markets.

The research will focus on gaining insight into presence by distinguishing the measurement of presence from other traditional measures: sales, growth rate, market share, return on investment, and so forth. Theoretical development can be aided by understanding whether the measures (or alternate measures) are really indicators of a different phenomenon.

In addition, the research will explore the effectiveness of presence in terms of definition. One area would be to consider how presence is related to competitive ability in the unclear environment of the future. There are a number of financial measures based on risk and return that are used to speculate on the future of the firm. Financial markets are, in essence, places to invest in the future; presence, as defined, is an indicator of expectation for the future in the product markets, and therefore is at the nexus of the financial and product markets. Presence as a measure of volatility (risk) in the product market could be contrasted with the information provided by the more traditional financial measures to help improve its conceptualization.

Presence is a new concept and the emphasis of this dissertation is to distinguish it better from the currently used measures and explore its potential effectiveness. Presence offers the potential to help in evaluating the impact of allocation of resources for long-term marketing investment.

Design

The study is composed of two stages: a pretest and the actual research. The pretest was conducted using local Michigan and Illinois money center banks, brokers, and a mergers and acquisitions specialist. The pretest had several purposes:

1. To refine the interview questions
2. To refine the interview process and train the researcher
3. To perfect the collection of information:
 - a. taped
 - b. notes
 - c. recall and dictation
4. To refine the work of the transcriber

Thus, the pretest served to refine and improve the collection and preparation of raw data. The pretest greatly facilitated collection and retrieval of information. The researcher, assistants, and transcriber became familiar with new terms and phrases and therefore were better prepared for the study.

The study itself was composed of interviews conducted across three industries: media, drugs and computers, and across seven firms as seen in Figure 7.

Information was collected by tape recorder and notes for later transcription and evaluation. The interviewer worked from a prepared list of topics attempting to focus the discussion on whether factors beyond the traditional financial information are considered in the valuation process.

The pretest served to generate additional items and to purify the questions being asked. It consisted of seven interviews across six companies, four banks, one brokerage house, and one firm that specializes

Firm	Industry		
	Media	Computer	Drugs
F	F-1		
G	G-3	G-1	G-2
H	H-2	H-1	
L		L-1	
N			N-1
P		P-1	
K			K-1

Figure 7

FIRM/INDUSTRY MATRIX

in mergers and acquisitions. The study consisted of ten industry interviews split equally between banks and brokerage firms.

All the information for the pretest was collected in September and the interviews for the main body of research were conducted in October and early November. Every effort was made to accomplish these in as short a time as possible in order that analysts and financial managers would not be unduly influenced by changing environmental factors.

Factors for Interviews

The first stage in the interview process was the development of a list of factors based on the research questions. This list is shown in Figure 8. These factors were developed out of the literature search that had been previously conducted. It was important to understand how financial analysts made valuation decisions and whether they were using any kind of product risk measure.

To do this several approaches were made to the topic. In arranging the list of factors a topic heading was chosen and, based on a review of the literature, some possible subfactors were listed. Factors one, two, and three provided information for research question four: Can evaluation be explained solely by traditional measures? Thus in the case of factor one, financial performance measures, it was felt that some likely components would be profits and growth rates. A heavy dependence on earnings related measures was expected because of their availability and ease of use.

In factor two, methods of valuation, the subfactors were the major valuation models commonly discussed in texts in finance. It was expected, based on the researcher's extensive work in finance, that the analysts

Factors to be discussed with the analysts:

1. Financial Performance Measures
 - A. Profits
 - B. Growth rates
2. Methods of Valuation
 - A. Capital Asset Pricing Model
 - B. Growth Models
 - C. Book Valuation
 - D. Asset Valuation
3. Using Firm and Industry Product Market Performance Measures
 - A. Market Share
 - B. Growth Rates
 - C. Return On Investment
 - D. Sales
4. Other Factors Affecting Capabilities
 - A. Technology
 - B. Environmental
 - C. Management
 - D. Product Markets
5. Consumer Information
 - A. Types
 1. Industrial
 2. Consumer Markets
 - B. Classification
 1. Purchasers
 2. Users
 3. Influencers
 4. Deciders
 - C. Types of Shopping Behavior
 1. Classification of Goods
 2. Low Involvement--High Involvement
 - D. Customer Research
 1. Awareness
 2. Evoked Sets
 3. Standard
 4. Generic

Figure 8

FACTORS TO BE DISCUSSED WITH ANALYST



- 6. Competitive Situation
 - A. Industry
 - 1. Innovation
 - 2. Barriers to Entry
 - a. Cost Structure
 - b. Time and Space Occupancy
 - 3. External Competition
 - a. New substitutes
- 7. Future Strength
 - A. Return
 - 1. Earnings
 - B. Risk
 - 1. Stability (carryover)
 - 2. Generic

Figure 8 (cont'd.)



would be very model dependent. In fact there was an expectation of a heavy use of beta and the capital asset pricing model. This would have made sense considering the availability of information and the computational facilities necessary to run these models.

The third factor focused on extant performance measures. The interest was in finding out what analysts used. There was the possibility that financial analysts have some measure of performance related to increase or decrease in product market risk. The subfactors listed were traditional marketing sales-based performance measures.

The fourth factor was designed to elicit from the interviewees other elements that might be affecting a firm's capabilities. It focused on the third research question, the need for a product risk measure. Here it was hoped that, in addition to some expected measures, product market risk might appear. Other areas were purposely included in order to promote discussion to bring out terms and concepts related to the research questions.

The fifth area, on consumer information, was an attempt to focus on what kinds of customer information analysts had available that might be useful in exploring product market risk. It relates research questions two and three. The effort here was to include as many areas as possible. Again, it was hoped that the analysts might come forth with how they were considering the impact of product market risk.

The sixth factor focused on competitive situation. The goal was to get the analysts thinking about how they evaluated companies in the same industry. Again, it was hoped to find something either directly or indirectly related to product market risk. This was included to provide insight to research question one on the relationship of shareholder

objectives, and research question four on the explanation of valuation by traditional measures.

The final factor was future strength. Since the product risk idea is based on market investments for the future it was assumed that it had the best chance of being discussed in an area that dealt with the future and, specifically, risk. This was expected to provide information to questions one and two focusing on the relationship between stockholder objectives and firm's objectives and the importance of product market risk in the financial market's valuation of the firm's prospects.

These seven factors, with the addition of some demographic information were combined into the eighteen questions that eventually formed the Interview Structure and Questionnaire, Figure 9. As each interview was conducted there was a real attempt by the researcher to be sure that every question was answered and that all topic areas were covered. Without this effort there would have been a natural inclination to wander to topics of mutual interest and comparison during interviews would have been impossible.

Interview Structure and Questionnaire

The interview structure and questionnaire had three main sections. The first section, questions one to three, asked general information about the analysts including their function, the kinds and size of funds dealt with and the kinds of securities followed. In terms of function it was designed to find out how they would classify themselves in terms of what they did. The second question, dealing with size of the funds that they were either responsible for or advising, was felt to be very important in establishing the experience credibility of the analyst. The third question

Interview Structure and Questionnaire

Questions

1. What is your function?
2. What kinds and size of funds do you deal with?
 - Pension funds
 - Individual Trust
 - Corporate Investments
3. Do you consider yourself an analyst?
 - What Industry
 - What Stocks
 - What Niche
 - What Size Firms
4. How do you arrive at a valuation recommendation? (Or determine a buy sell decision for securities?)
5. What is your horizon for valuation in financial markets?
6. What is your horizon for holding securities in financial markets?
7. Do you use any of the standardized models for valuation, such as:
 - Dividend Growth
 - Capital Asset Pricing Model
 - Earnings Growth Rate
 - Asset Valuation (Market to Book, etc.)
 - P/E
8. How do you evaluate a firm's future strength?
 - Return
 - Earnings
 - Risk
 - Financial Market Risk (beta, systematic)
 - Interest Rate Risk
 - Operating Risk
 - Cyclical Products
 - Product Life Cycle
 - Product Market Development
 - Stability
 - Standard
 - Generic
9. How do you use the industry competitive situation in your analysis?
 - Internal Industry
 - Structure
 - Barriers to Entry

Figure 9

INTERVIEW STRUCTURE AND QUESTIONNAIRE

Cost Structure
 Time and Space Occupancy
 Distribution Network
 External
 New Substitutes

10. Do you use any indicators of product market performance?

11. How do you use historical firm and industry product market performance measures in valuation?

Market Share

Growth Rate

ROI

Sales

Degree of Operating Leverage

Chng EBIT

Chng Sales

12. What do you use as indicators of product market performance:

For the long term (3-5 years)?

For the short term (0-2 years)?

13. Do you do any product market customer research? Or, purchase it?

If so,

What kinds of customer information do you seek for use in valuation?

Types

Industrial

Consumer

Classification

Purchasers

Users

Influencers

Deciders

Shopping Behavior

Classification of goods

Low Involvement -- High Involvement

What do you look for in your product market customer research?

Awareness

Evoked Sets

Standard

Generic

Satisfaction

Substitutes

Competition

14. How do you use your product market customer research in your valuation?

Figure 9 (cont'd.)

15. What other factors impact valuation, aside from financial and product market information?
 - Technology %
 - Management %
 - Environment %
 - Market Related %
16. Do your accounting principles (GAAP) hinder management from taking a long-term view of the firm?
17. Since marketing costs are expensed, are long-term market investments hindered by our financial evaluation methods?
18. How would you rank the top three stock in your industry?
 - For an institutional account?
 - For an individual investor?
 - tax consequences

Figure 9 (cont'd.)

was to confirm that they were active, functioning analysts.

The second section, questions four to fifteen, was developed from the list of seven factors. The third section was composed of three questions that became evident during the first couple of interviews. Question sixteen dealt with the impact of accounting principles on management and was suggested by comments made at an early interview. Question seventeen was suggested similarly and focused on the problems of expensing marketing investments. Question eighteen focused on what stocks analysts were currently recommending. Here the attempt was to learn not only what stocks the analysts were currently recommending and, but also, whether there were any difference in the recommendations for institutions or for individuals. The assumption was that if institutions had different holding periods than individuals then recommendations might be different. It was thought that individuals with longer term holding periods would be recommended stocks with more product market stability or lower product market risk.

Expectations

In looking at the questions in the Interview Structure and Questionnaire (Figure 9), there are a number of results that were expected in relation to the four research questions. This will be structured around the four research questions.

1. What is the relationship between stockholder objectives and firms' objectives?

Interview questions five and six, on the horizon for valuation and holding, were expected to provide insight into the relationship and into the idea that there might not be one set of stockholder objectives. It was

thought that there would be substantial differences between individual financial analysts and investors on the horizon for valuation, with individuals using longer term horizons and pension funds using shorter term horizons. Holding periods were also expected to vary but it was assumed that most investments would be made for a minimum of a year. It was hoped that there would be developed some understanding of what is meant by the goal of maximization of shareholder wealth and how that relates to firm's objectives. In the literature there is a tendency to talk about the maximization of shareholder wealth over the long term. Question eight, on the valuation of a firm's future strength, was also expected to help in understanding how shareholders might relate to the firm. Investors are obviously buying for the future; how do financial analysts representing investors make their valuation for the future? It was anticipated that there would be a relatively detailed look at the future, including elements of product market risk. Question sixteen, regarding the influence of Generally Accepted Accounting Principles (GAAP), was expected to make clear whether or not the shareholders were looking beyond published reports. It was thought that GAAP might prove a real hurdle for investors because of the necessity to reinterpret information. Analysts were provided a number of opportunities to comment on the objectives of stockholders and how they might relate to management's objectives.

2. What is the relationship of product market risk to the financial markets?

This was addressed in questions five and six, looking at the valuation and holding horizon with the expectation that the further into the future the horizon went, the more likely that investors would look at product

market risk. In question seven, the goal was to find out how much models were used since the models do not have any direct product market risk inputs. Question nine, on the industry structure, was included to approach product market risk in an alternative fashion. It was felt that if analysts were looking at product market risk, they would be looking at industry structure as a related concern. Questions ten, twelve, thirteen, and fourteen were included as direct approaches to ascertain how analysts used product market information in their evaluation processes. It was expected that analysts would look in some detail at product market risks since the sales to customers are conceived as the beginning of the income stream from which all profits are drawn. Question fifteen, on other factors, was included to give analysts another chance to allude to their use of product market information in their own terms. Question seventeen, on the problems of expensing marketing investment, was included to discover how much analysts were thinking about product market investment. It was expected that they would be familiar with this problem and have comments on it. Thus the question of how product market risk relates to the financial markets was included in a number of different ways.

3. What are the needs for a product market risk measure?

Since it was not known how much product market risk was used by practitioners (or whether they had developed an applied method of using product market risk) there were no specific questions on this topic. A number of the questions tried to focus on how important product market risk was to this sample, as discussed in research question two above, and a number of questions were related to what type of measure would be most useful.

Questions four and seven, on how analysts arrive at valuation and what models they use, were expected to elicit information about any direct use of a product market risk measure. Questions ten, twelve, and thirteen on product markets were all aimed at discovering how analysts currently used product market risk and what the problems were if no risk measure was currently being used by practitioners. There was no expectation of what would be needed. The goal was to find out what would be useful and why product risk was not considered more.

4. Can evaluation be explained solely by traditional measures?

Question four of the questionnaire was directly related to this research question. It was possible that analysts would say that they used the textbook measures. This was not expected as it would have indicated little use for analysts since most current measures and models could be computed from available data with relative ease. Question seven on the models provided the same opportunity. Question eight was included because it applied to all research questions; for this discussion it gave an opportunity for analysts to reveal how they traditional measures to evaluate future strength. It was expected that analysts would reveal a number of new considerations in the evaluating process. Question eleven provided analysts an opportunity to explain how they used traditional marketing performance measures. It was not known how these are being used since they are not included in most financial models. Questions thirteen and fifteen provided the opportunity for the analysts to provide other information about practitioner developed models that included other items than those considered in the academic literature. It was not expected that much would be found because the academic community is closely tied to the applied areas, particularly in finance. In summary,

there were a number of questions included to give the analysts an opportunity to explain if they were fully satisfied with current measures or whether they were using other factors on a subjective basis. The expectation was that there would be other factors.

Content Analysis

In addition to the careful review of all transcripts of the interviews on a subjective basis, the written transcripts were content analyzed. Content analysis allows the investigator to ask questions of communications produced by the sample, in this case the transcripts of interviews (Kerlinger, p. 525). In order to do the content analysis it was necessary to develop a coding system. To do this, a sample of three interviews were studied to develop a common list of phrases and terms. These were organized into common categories and subcategories under each question. There was one interview from each of the three industries and both banks and brokerage firms were represented. These terms were then used to do the content analysis.

Content analysis may be performed at different levels; for example, themes, words, characters, items, and space and time measures, (Bereleson). Clearly in this case the research at its exploratory stage was focusing on themes. Kerlinger cautions that these are difficult units to content analyze (Kerlinger p. 529). He goes on to state:

...that if the themes are complex, content analysis using the theme as the unit of analysis is difficult and perhaps unreliable. Yet it is an important and useful unit because it is ordinarily realistic and close to the original content. (Kerlinger, p.529)

It was felt that the risks involved were worth taking to maintain the

integrity of the ideas that the analysts had shared. The content analysis master developed, Figure 10, shows the major items for each question and the sub-items.

All information was content analyzed for all subjects (seven pretest, three general and ten industry studies). Each file was read by two readers who did their own analysis using the preselected terms. The analysis was done question by question. Frequently, this meant reading through the entire file for each of several questions as interviewees would tend to go back to previous questions as the interviews developed.

When each reader had completed his analysis, the analyses were compared. When any discrepancy arose, the readers would seek resolution in the source document. Because of the availability of the transcript, raw notes and dictated notes of the interviewer, all questions were able to be resolved from source material and there appeared to be no need for a judge.

The results of the content analysis are divided into two categories:

1. Code phrases and terms using the content analysis master (Figure 10).
2. Comments by way of explanation for each question for every interviewee (see Subject Content Analysis, Appendix A).

It is felt that this provided somewhat objective information in the form of the coded responses while maintaining the desired subjectivity in the additional comments.

Coding

One hundred and sixty four dichotomous variables were coded. If the respondent had discussed the item it was coded as a "1," if the item had

Question 1 - Category d

- d1 Fundamental Analysis
 - Of industry
 - Of company
 - Identify critical variables
 - Trends
- d2 Seeking Non-consensus position
 - Where Is Consensus Wrong?
 - Consensus Does Not Allow One To Make Money (?)
 - Changes in Expectation against Perception
 - Crystal Balling
- d3 Getting to Know Management
 - Spend Time with Companies
 - Understanding Companies' Role
 - Companies Are Good or Bad Based on Long-Term Views
 - Good Stocks = Good companies
- d4 Formula Approach
 - Centralized
 - Strong Committee Structure
 - Optimal Portfolio
 - Approved List
 - Objective
- d5 Earnings Focus
 - P/E Focus
 - Relative P/E Using S & P 500
 - Stocks are Good or Bad, Based on Prices
- d6 Decentralized
 - Subjective
 - Loose Formula
 - Segment Thinking
- d7 Risk
 - Downside
 - Upside Potential
- d8 Is CEO Doing Right or Wrong?
 - a. Put Yourself in the Position of Chairperson or President
 - b. As CEO Do Right or Wrong Thing
 - c. Strategic Picture in Product Market
- d9 Macro Market
 - Economic forecast
 - Topdown

Figure 10
CONTENT ANALYSIS MASTER

Question 2 - Category E

- E1 Official Time Horizon
00-24 Months
- E2 Official Time Horizon
24-60 Months
- E3 Official Time Horizon
Greater than 60 Months
- E4 Analyst Focus
00-18 Months
- E5 Analyst Focus
24-60 Months
- E6 Analyst Focus
Greater than 60 Months
- E7 Windows of Opportunity where World is Wrong

N/A - No Answer

Question 3 - Category F

- F1 Long Term
Private Trust
Families
- F2 Shorter Term
Hours to 2 Years
- F3 Two Tiered Approach
40-70% Long-Term
30-60% Actively Traded

Question 4 - Category G

- G1 Standardized Models Available
 - a. Available in House
 - b. Massage? with Computer
 - c. Use as a Check
 - d. Models Need Correct Future Inputs To Be Correct
- G2 Models Cited
 - a. Beta = Beta
 - b. Dividend Growth = DiGr
 - c. Low P/E = L P/E
 - d. Proprietary = Prop
 - e. Macro Economic Model = MEcM

- G3 Models Are Part of Technical Analysis
Dividend Growth Rate - Implicit Growth Rate to Compare to
Estimated Secular Growth

Question 8 - Category H

- H1 Return
Earnings
- H2 Financial Market Risk
a. Beta, volatility
b. P/E Drive - P/E Volatility
c. Inflation
d. Product Standard a Generic
Positive P/E of Firm
Negative P/E of Competing Firms
- H3 Interest Rate Risk
a. (Opportunity/Risk)
b. Critical Variable
c. Volatility Factor
- H4 Operating Risk
a. Economic Cyclicalilty
b. Risk of Going under
c. Risk of Serious Financial Troubles
d. Marginal Revenue Impacted by Competition
- H5 Product Market-Risk
a. Product Acceptance
b. Product Standard - Positive P/E
c. Product Generic - Positive P/E
d. Product Stability
e. Product Life Cycles
f. Product Transitions
g. Market Share
h. Marketing Cannibalism
i. Product Substitutes
- H6 Volatility
Major Component of Risk
- H7 Strategic Implementation Risk
a. Degree of Technical Risk
b. Management Experience (track record)
c. Internal Controls
d. Strategy makes Sense
e. Quality of Company

- H8 Industry Risks
 - a. Structure
 - b. Competition
 - Technology
 - Competitive Thrust
 - Product Substitute
- H9 General Risk
 - Risk Is Conceived of in a General Way
- H10 Company Specific Risks
 - a. Strategy
 - b. Product Life Cycle
 - c. Product Transitions
 - d. History - Track Record

Question 9 - Category I

- I1 Barriers to Entry (Industry Structure)
 - a. Capital
 - b. Customer Based
 - c. Time and Space Occupancy (Switching Cost)
 - d. Distribution Network
 - e. Technology
- I2 Markets (Industry)
 - a. Growth Rate
 - b. Market Potential
 - c. Segmentation
 - d. Franchises
- I3 Industry Opportunities
 - a. Changes in Technology
 - b. Windows of Opportunity
 - c. Pioneer Status
- I4 Industry Averages
 - a. Technology
 - b. Cost Structure

Question 10 - Category J

- J1 Secondary
 - a. Consultants
 - b. Survey results
 - c. SellSide Analyst
 - d. Trade Associations



- J2 Primary Research
 - a. Individuals
 - Joe Fuchs Media Advertising
 - b. Professional (Product Evaluation and Customers)
 - Computers
 - Gartner, Datapro

Question 11 - Category K

- K1 Historical Measures
 - Used as a Check with Trend Analysis
- K2 Market Share

Question 12 - Category L

- L1 Short Term
 - a. Focus
 - b. Market Volatility
 - c. Economic Volatility
 - d. Study Buying Intentions
- L2 Short Term Options
 - a. What Can Be Done to Raise Earnings
 - b. Delay Product Introduction
 - c. Delay Write Offs
 - d. Other Short Run Options to Raise Earnings

Question 13 - Category M

- M1 Purchase Product Market Customer Research
 - a. Hire Consultants and Buy Materials
 - b. Nielsens
 - c. Trade Associations
- M2 In House Product Market Customer Research
- M3 Obtain Product Market Customer Research from Sellside
- M4 Future Orientation
 - a. High Involvement Allows You to Obtain Information Substantially in Advance.
 - b. Future Based on Company Wide Trends.
 - c. Future Based on Analyst (Consultant) Proprietary Contacts
 - d. Dataquest, Gartner Group, Dorothy Seabold, Prime Data
- M5 Customer Information
 - a. Consumer Information
 - b. Kinds of Purchasers
 - c. Customer Preference Surveys

- M6 Results of Customer Research
- a. Earnings
 - b. Market share
 - c. Threats
 - d. Opportunities
 - e. Stock Cycle
 - f. Unit growth
 - g. Adjust Rating to Value
(i.e., Advertising to Prime Time)

Question 14 - Category N

- N1 Subjective Input to Valuation
- a. Helps with Growth Estimates
 - b. Helps with Models and Relationships (They are Only as Good as Inputs.

Question 15 - Category Q

- 01 Management (Historical)
- a. Most Important
 - b. Sellside Concentrates on Management
- 02 Technology (Research Effort)
- a. Future Oriented
- 03 Macro Environment
- 04 Products and Customer Research

Question 16 - Category P

- P1 GAAP - May Cause Misstatement of Earnings
- P2 Management Are Conservative in Use of GAAP
- P3 Analysts Look beyond Account Statements
Changes in GAAP should Not Impact valuations
- P4 Accountants, Lawyers, Computers Hinder Everything.
- a. Rules Lead to Incorrect Reporting
 - b. Computerization Leads to Oversimplification

Question 17 - Category Q

- Q1 No
- Q2 Amortization by Product Life Cycle May Vary with Producer

Q3 More Inefficiencies Create More Work for Analyst

Q4 May Impact Timing Such as Growth of Sales

Q5 Depends on Reasonableness of Strategy to InvestmentCommunity

Q6 Yes

Question 18 - Category R

December 5, 1985

Figure 10 (cont'd.)

not been discussed it was coded a "0." It is important that "0" does not indicate a "no" but rather it indicates that the interviewee did not discuss this issue or did not feel it was an important factor in the discussion. For example, a number of interviewees, when asked about financial models, indicated that their firms had such models but that they never looked at most of them. They would be assigned a "1" only for the categories in which they indicated use. The dichotomous variables were coded on to a mark sense document to be optically scanned and then processed for frequency and crosstabulations.

Frequencies

Frequencies were run on all variables to obtain a better demographic profile and to look at any absolutes. This did not provide particularly useful information with the exception of the demographics of the sample which will be discussed later in the results of the research.

Crosstabulations

Crosstabulations were run on all variables in order to study the relationship between responses. Even though the sample size was extremely small, crosstabulations were used as a method of sorting through the mass of coded information for the important content.

Because of the small sample size it was only the rare crosstab that would meet the requirements for chi square:

"...the sample size must be such that no categories have zero observations and no more than 20 percent can have less than five, the distribution of the variables in the population across the scale categories must be specified, and only a two-tailed test of significance is provided by chi-square....(Kurtz, 1983, p.173)

$$x_{i,j} = \frac{1}{n} \sum_{k=1}^n x_{i,j,k} = \frac{1}{n} \sum_{k=1}^n \frac{1}{n} \sum_{l=1}^n x_{i,j,k,l} = \frac{1}{n^2} \sum_{k=1}^n \sum_{l=1}^n x_{i,j,k,l}$$
$$V_1 \cup V_2 = V, \quad E_1 \cap E_2 = \emptyset, \quad E_1 \cup E_2 = E$$

1. 1990年12月31日，某公司资产总额为1000万元，负债总额为400万元。1991年1月1日，该公司宣告分派1990年度股利100万元。1991年12月31日，该公司资产总额为900万元，负债总额为300万元。则1991年1月1日至1991年12月31日止，该公司所有者权益增加了（ ）万元。
 A. 100 B. 200 C. 300 D. 400

The greatest problems came in the small sample size, because of the frequency of categories with zero, as well as the large number of categories with less than five. Since there were only twenty respondents to be spread across each two by two crosstabulations, unless they were evenly distributed, there was always a category with less than five.

It was still desired to review all the information for any important factors that might have been overlooked in the subjective reading of the interview transcripts. The phi coefficient was used as a method of scanning through the crosstabulations for anything that might have been significant in a larger sample.

Phi coefficient...is... popular...for evaluating the
association between two dichotomous variables....
the coefficient can be interpreted as a PRE measure....
(IBID, p. 303)

A proportional reduction in error(PRE) measure provides only a sense of the association between variables (IBID,1983, p. 300), but that is all that could be expected from the small convenience sample that was used for this initial exploratory research.

Using phi as a screen (see Figure 11), all of the crosstabulations were examined for any indication of significance. Those that showed an indication on the PRE measure were noted. All noted crosstabulations were then sorted back to the topics of the original question. This allowed the researcher to once again review all the material by topic and question, while at the same time have an indication of what points were important. This information was then validated by a return to the original interview transcripts in the development of the overall model. The material used will be discussed in chapter five.

D1
Fundamental Analysis

F1
Long-Term Holding Period

	0	1
0	0 a	2 b
1	16 c	1 d

$$\phi = \frac{bc - ad}{\sqrt{(a+b)(c+d)(a+c)(b+d)}}$$

- A. $\phi = -.61$ Negative Association
- B. % Explained = .37
- C. Significance = $n\phi^2 = 7.4$
- D. Significant to .02.

- A. Phi Coefficient
- B. PRE (Percentage Reduction in Error)
- C. Significance Test Based on Chi Square Significance Test
- D. Significance Determined as Follows...
2x2 Table Has 1 Degree of Freedom

(From Kurtz, 1983, page 300-303)

Figure 11

TYPICAL CROSSTABULATION

Conclusion

This is an exploratory study to develop understanding. Given the limitations of a convenience sample, every effort has been made to explore the qualitative data collected in a number of ways; direct transcripts in both tape and written form and content analysis. The limited statistical procedures that were used in the study research focused on understanding and developing the model of the relationship between the product market performance and the financial market performance, as it applies to presence. Chapter five is a general review of the results of the research.

Chapter Five

Results

It is important, while reviewing the results, to remember that the best that can be expected from the type of qualitative study conducted is some explanation. While the results of the study are shown in raw scores and as percentages, this is not done as an indication of statistical support, but to inform the reader of the kinds and quantity of information that are available in addition to the extensive transcriptions of the interviews.

The discussion will follow the four research questions developed in chapter one. The model developed in chapter six is a result of both the transcripts and the crosstabulation analysis. The insights gained from the research will be discussed in this chapter. The development of product market risk and the explanatory model are seen in chapter V.

General Information

This was the first section of the interview questions, questions one to three.

1. What is your function?

The interviewees classified themselves into one of three job categories, Table 1.

TABLE 1
INTERVIEWEES JOB CLASSIFICATION

Broker	1	5%
Analyst	14	70%
Portfolio Manager	5	25%

A broker actually buys and sells stocks for clients. They may do their own research and analysis as was true of the single broker interviewed. This broker was recommended by two analysts. Analysts concentrate on researching and making recommendations on firms that they are assigned to follow. Portfolio managers actually move the money around changing investments according to their best judgment, or according to a model. Portfolio managers are heavily dependent on analysts for information. Many portfolio managers use analysts both inside and outside their firms. For the remainder of this discussion, the term analysts is used to refer to all twenty respondents.

2. What kinds and size of funds do you deal with?

Almost all the analysts were dealing with a combination of funds. The primary source is pension funds which seem to dominate the portfolios of the bankers and the minds of the sellside analysts who are interested in their larger commissions. Second is corporate investments, and finally, charitable and individual trusts and foundations. One trust company, with three analysts, was the notable exception as they specialized in handling trust accounts for wealthy individuals.

The financial market may be thought of as having three major classifications: institutions, for example, banks as described above with large portfolios of pension funds; corporate investments, corporations managing their own investments; and individual trusts, individuals

managing their own investments.

3. Do you consider yourself an analyst?

This question was answered in question one above , but also elicited the response as to what industry the individual followed (Table 2).

TABLE 2
INDUSTRIES FOLLOWED BY RESPONDENTS

Media	3	15%
Computer	5	25%
Pharmaceutical	2	10%
Generalists	8	40%
Manufacturing	1	5%
Merger and Acquisition Broker	1	5%

This question led to an understanding of the large differences in the number of firms that individuals in the sample were following. Some were following a few firms in an industry but used an industry classification. At the other end of the spectrum respondents classified themselves as generalists and were following one or more industries to the entire financial market.

Another factor that is important is the location of the respondents. Those respondents located in or around New York City seem to feel that they are in the hub of the financial markets and therefore closer to the market psychology, as will be explained later.

TABLE 3
LOCATION OF RESPONDENTS

New York (New York City)	8	40%
Illinois (Chicago)	5	25%
Michigan	6	30%
Conneticut (N.Y.C. suburb)	1	5%

An unexpected development was the way in which analysts classified themselves by employer. The two classifications are buy-side and sell-side.

Buyside analysts work for banks and other institutions whose principal incomes comes from the management of money. They are called buyside because as they or the portfolio managers who work for their institutions buy, they have the ability to generate large commissions for the brokerage houses.

Buyside analysts represent banks, insurance companies, individuals, and corporations. Sellside is so named because their primary sources of income is generated from commissions received from the sale of information and brokerage activities. Sellside, then, is those who sell brokerage services.

TABLE 4
BUYSELL CLASSIFICATION

Buyside	15
Sellside	5

The five respondents on the sellside tended to mention several other factors that may impact their valuation.

TABLE 5
FACTORS MENTIONED BY SELLSIDE

1.	Other Areas of Product Market Customer Research.	100%
2.	Two Tiered Holding (The Majority of the Portfolio Is Regularly Traded but There Are Some Securities Which Are Held for Longer Periods of Time).	80%
3.	In House Product Market Customer Research (The Respondent or the Firm Is Involved in Direct Product Market Research).	80%
4.	Official Time Horizon of 0-24 Month	80%
5.	Product Market Risks	60%
6..	Analyst's Time Horizon	60%

The predominant interest in trying to obtain information about the actual product market customer was on the analyst representing the brokerage houses or sellside. This is of interest in relation to their shorter official horizon; it had been believed that the longer term investor would look further towards the customer in an attempt to gain information that might help develop an expectation about the future.

Other areas that might indicate a future direction on the sellside are the study of buying intentions as a short-term measure and the focus on industry averages as a corporate measure.

In sum, there are differences in the way the analysts approach valuation depending on the business of their employer. The buy-side has more of an earnings focus and the sellside has more of a product market customer research focus.

Results by Research Question

The results of the interviews from both the content analysis and the transcripts will be presented following the order dictated by the research questions from chapter one.

Research Question One

What is the relationship between stockholder objectives and the firm's objectives?

Questions five and six, on time horizons and anticipated holding periods, were designed to provide input on this research question. It was expected that there would be substantial differences in the horizons for valuation and holding. The official time horizon represents the official policy of the employer of the analyst. Analyst focus represents what the

analysts stated as their own horizon for valuation.

TABLE 6
OFFICIAL TIME HORIZONS

E ₁	0-24 months	8	40%
E ₂	25-60 months	8	40%
E ₃	>60 months	1	5%

Of the eight respondents who mentioned an official time horizon of 0-24 months, a number mentioned related factors, to the short-term horizon for valuation (Table 7). Of the eight people who mentioned an official time horizon of 25-60 months, five mentioned that they also looked at the product market and industry information in their valuation.

The short term official time horizon for valuation was a surprise. It had been expected that they would have a longer term view than five years. The analysts were expected to have a slightly shorter time frame, but what was unexpected was that most of them could not give a specific time period. Those who did were in the 25-60 month horizon (Table 8).

Only five analysts mentioned their time horizon for valuation. Most of them talked about the need to be immediately responsive to changing market conditions. Of the five who gave a direct response to the question, all of them cited 24-60 months. Table 9 includes some of the more frequently mentioned items by the five.

TABLE 7

IDEAS MENTIONED BY ANALYSTS WITH 0-24 MONTH OFFICIAL HORIZON

1.	Analysts Looking beyond Published Statements.	75. %
2.	The Use of Customer Information: Consumer Information Kinds of Purchases Customer Preference Surveys	62.5%
3.	The Purchase of Research to Help Understand Product Markets.	50. %
4.	The Use of Purchased Research to Help Determine Stock Cycles. (The Product Markets May Give Advanced Warning to the Financial Markets.)	50. %
5.	Seeking a Non-consensus Position in the Market. Study of a Given Set of Information May Lead Different Analysts to Different Perceptions. (Careful Study of the Near Future May Provide an Analyst with an Information Bit Not Recognized by Other Analysts.)	37.5%
6.	Market Potential for the Industry Used as Part of the Industry Competitive Situation in the Analysis.	37.5%
7.	Use of Individual Respondent's Primary Research as an Indicator of Product Market Performance.	37.5%

TABLE 8

ANALYST'S HORIZON FOR VALUATION

E ₄	0-24 months	0	0%
E ₅	24-60 months	5	25%
E ₆	>60 months	0	0%

TABLE 9

ITEMS MENTIONED BY ANALYSTS WITH 25-60 MONTH FOCUS

- | | | |
|----|--|-----|
| 1. | Industry Opportunities
Changes in Technology
Windows of Opportunity
Pioneer Status | 80% |
| 2. | Future Orientation in the Purchase of Product
Market Customer Research. | 80% |
| 3. | Future Oriented Look at Technology. | 80% |
| 4. | GAAP May Cause a Misstatement in Earnings
because of the Inability to Reflect Some
Investments such as Marketing or the Amortization
of Goodwill. | 60% |
| 5. | Studies of Buying Intentions | 40% |

Question six, asked about the holding period of the firm. There are essentially three items that came out in the content analysis: long-term, short-term, and the two tiered approach. The long-term only appears in the case of the respondents at one organization that specializes in handling the funds of affluent families. Almost all their clients count their wealth in the millions. This organization was included in the study because they manage large investments and if, as asserted in chapter one, longer term investors were looking at different factors it would be confirmed by these interviews.

TABLE 10

DISTRIBUTION OF HOLDING PERIODS

F_1	Long Term	5	15%
F_2	Short Term	8	40%
F_3	Two Tiered	5	25%

The eight analysts who mentioned short-term holding also mentioned other items.

TABLE 11

ITEMS MENTIONED WITH SHORT-TERM HOLDING

1.	Risk as a Component in Valuation	4	50%
2.	Survey Results as an Indicator of Product Market Performance.	4	50%
3.	The Idea that Long-Term Market Investments Hindered Financial Evaluation Methods because They are Expensed.	4	50%
4.	Financial Market Risk.	4	37.5%

It is worth noting that none of them mentioned market share. Those who mentioned short-term holding periods tended to be very concerned with risk both in the product and in the financial markets.

The two tiered holding period was cited by five respondents, who indicated their belief that the bulk of stocks in their firm's portfolio was traded frequently but that a small proportion were long term holdings. The turnover rate of portfolios was quoted as being being over one hundred

percent by several analysts. Several items were mentioned with the two tiered holding period (Table 12).

TABLE 12.

ITEMS MENTIONED BY ANALYST WITH TWO TIERED HOLDING PERIODS

1.	Future Orientation to Looking at Product Market Customer Research.	4	80%
2.	Sellside	4	80%
3.	In House Product Market Customer Research.	4	80%
4.	Customer Information as Product Market Customer Research.	4	80%
5.	Industry Opportunities.	4	80%
6.	Use of Macro Economic Model.	3	60%
7.	Study of Buying Intentions.	2	40%
8.	Market Share.	2	40%
9.	Threats Perceived as a Result of Product Market Customer Research.	2	40%

It may be that the two tiered holding period is acting as a surrogate for the sell side. There may be an association with a number of the factors that indicate an interest in the product market to help estimate future results.

In summary, the time frame for valuation and holding periods appeared to be much shorter than originally anticipated. Many of the respondents to the questions were dealing in very actively traded portfolios. The surprise was the short-term holding of many securities which came out in discussion, but not in direct response to the question. Thus the term maximization of shareholder wealth needs to be reconsidered from an assumed horizon of three to five years to a much shorter time frame if marketing management is to be able to tie more

clearly to financial strategy. There remains the question raised in chapter three as to whether the objectives of the various stakeholders in the firm are the same. If it is assumed that the goal is to maximize shareholder wealth then this study raises some issues as to what that term means. It appears that shareholders may have a very short-term view of shareholder wealth maximization as represented by analysts.

Research Question Two

What is the relationship of product market risk to the financial markets?

Interview questions five, six, seven, nine, ten, twelve, thirteen, and fourteen apply to this research question. Questions five and six asked about the valuation and holding horizons and were discussed above. The assumption had been made that the longer the horizon for valuation, the more likely analysts representing investors would look at the product market and product market risk. The surprising lack of commitment to long-term valuation or holding as shown does not support a strong relationship between product market risk and financial markets.

Question seven was designed to find out how frequently standardized models are used in valuation. This question will be fully discussed below, but it is important to note that the most popular model cited by seven out of twenty analysts was the dividend growth model which does not have any direct product market risks inputs, as discussed in chapter three.

Question nine was aimed at the use of the industry competitive situation in the analysis process. It was anticipated the industry information would be very important in any product market risk input into financial markets. Only six out of twenty analysts focused on the industry

(Table 13), because of the conglomerates, and lack of clear definition. Only one (L-1) really focused on the industry competitive situation. Industry analysis was more common for financial comparison rather than the product market.

TABLE 13
INDUSTRY CONTENT ITEMS

Content Items	Raw Score	Percent
Barriers to Entry	4	20%
Markets	4	20%
Industry Opportunities	6	30%
Industry Averages	4	20%

Question ten was aimed directly at product market risk looking at indicators of product market performance.

The major content analysis items for the six respondents to this question were secondary research, such as provided by consultants, sell side analyst to buy side, trade associations and so on, and primary research. There may be an association between the use of secondary information and other items useful in understanding better corporate performance including operating risk and decentralized valuation structure.

While there was much less product market research going on than expected, it was important to find it going on even if only in a limited way. The risk of the product markets may be better understood if the researcher can be provided product market risk measures and better information on how product market risk might relate to the financial markets. Table 14 shows the number of analysts out of twenty that cited some form of product market research.

TABLE 14
TYPES OF PRODUCT MARKET RESEARCH

Secondary Research	6	30%
Surveys	5	25%
Consultants	3	15%
Trade Associations	2	10%
Primary Research	2	10%

Question twelve focused on the use of indicators of product market performance. What do you use as indicators of product market performance: (1) for the long term (3-5 years), and (2) for the short term (0-2years)?

Responses were classified into two major content items: short-term items and short-term options. There were only three respondents that mentioned short-term items which were classified into four areas: (1) Focus, (2) Market Volatility, (3) Economic Volatility, and (4) Study of Buying Intentions.

Only three respondents indicated short-term options and no one discussed long term indicators of product market performance in response to this question. This is in contrast to the expectation that analysts would be looking at product market risk. It seems clear that those respondents who are looking at indicators of product market performance are doing so in the short term. This supports the general short-term focus that was found. An important problem may have been the time spans that were chosen for definition of short and long term. In future studies it might be advisable to adjust those time periods to holding periods reflective of the short horizons of much of the financial market, as cited by analysts.

Question thirteen, was critical to the research as it focused on how directly respondents look at the product markets under the assumption that it would impact their valuation methods. The content items that were used are covered individually.

The first item is the purchase of product market customer research (Table 15). It was important to emphasize continually the product market customer research since financial markets have a different set of customers. Four of the twenty respondents reported that they did purchase customer research. Some of the most important items were mentioned by the same people doing product market research. In every case, the attempt was to understand in advance stock cycles or reduce risk for the future. Also, every one who reported doing this kind of research was in a decentralized structure, and operating on the shorter time horizon for valuation of 0-24 months, and most of them used survey results. This will be developed more fully in chapter six as it is shown that apparently an analyst has a choice of directions to look: the financial markets, the product markets, and the corporations themselves.

TABLE 15

ITEMS MENTIONED BY PURCHASERS OF PRODUCT MARKET RESEARCH

Decentralized Valuation Structure	4	100%
Short-Term Focus	4	100%
As an Indicator of Stock Cycles	4	100%
Survey Results	3	60%
Use of Consultants	2	40%

The second content item was actual in house product market research. In this case five out of the twenty firms were doing actual research themselves (Table 16). Four of the five mentioned being on the two tiered

...the ...

holding period and a longer term analyst focus of 24-60 months. Three of the five mentioned looking at industry averages as an indicator. It is interesting that the longer term views by the same analysts look forward to the product markets and look at other things besides published earnings.

TABLE 16

ITEMS MENTIONED BY THOSE DOING IN HOUSE PRODUCT MARKET RESEARCH

Analyst Focus for Valuation: 24-60 Months	4	80%
Two Tiered Approach to Holding Period	4	80%
Sellside	4	80%
Industry Average	3	60%

The third content item is obtaining product market research from the sellside. Seven of the twenty firms depended on the sellside for their original research. While the sample is small, it appears that most of the primary research that is going on in the product markets is being done on the sellside and then distributed to the clients, starting with the largest commission payers (meaning the institutions). After the institutions have the information it is rapidly distributed through out the system of persons interested in financial markets as has been suggested by students of finance either directly or via the rumor channel.

The fourth content item is a future orientation looking at product market research. This item is important to this research, based on the discussion in chapter one of this thesis for a product market risk measure. Five respondents were interpreted to have a future orientation on the basis of mentioning the following sub-items of future orientation in the content analysis, (M₄):

1. High Involvement (in Product Markets) Allows You to Obtain Information Substantially in Advance

2. Future Based on Companywide Trends
3. Future Based on Analyst's (Consultants) Proprietary Contacts
4. Specific Consulting Groups

Those who were classified in the content analysis as having a future orientation also mentioned in house product market research, with the two tiered approach, sellside and customer information. It is interesting that the items mentioned appear to be related to research in the product market occurring on the sellside. Perhaps a future study could concentrate more on the sellside analysts to verify how much is going on. It appears the analysts interviewed in this case are looking at what is going on in the product market as an indicator for the future.

TABLE 17
ITEMS MENTIONED BY THOSE WITH FUTURE ORIENTATION

Sellside	5	100%
Customer Information	5	100%
Two Tiered Approach to Holding	4	80%
In House Product Market Research	4	80%

The fifth item is customer information as a means of doing product market customer research (Table 18). The six analysts who mentioned customer information also tended to mention two other future oriented areas including market potential as an industry indicator and the importance of a future oriented research effort in technology. One may be a measure of market size and the other of market investment.

TABLE 18
ITEMS MENTIONED BY THOSE SEEKING CUSTOMER INFORMATION

Sellside	5	83%
Future Orientation	5	83%
Analysts Look Beyond the Statements	5	83%
Official Time Horizon	5	83%
Technology and Research	5	83%
Two Tiered Approach	4	67%
In House Product Market Research	4	67%

The final content item is the results of customer research. This was divided into a number of sub-parts that are important because they indicate the kinds of things that the twenty respondents were doing.

TABLE 19
SUB-PARTS OF CUSTOMER RESEARCH

1. Stock Cycles (Identification)	4	20%
2. Market Share	2	10%
3. Threats to the SBU	2	10%
4. Opportunities	1	5%

Results of customer research appear to be associated with a concern for marketing investment timing and reasonableness.

Question 14: How do you use product market research in your valuation?

Product market research is used in a subjective manner when it is available. This was the consistent response by all who use product market

research. There appears to be no structured way of integrating these product market factors into financial thinking at this time.

In response to research question two there are many different ways that the product market may be considered. Unfortunately, there appears to be no structured concept of how to include product market risk or any measures to work with it. That few analysts are doing things is indicative of the potential for marketing to contribute substantially, if it can develop useful theory and methods for handling product market risk. There was less work being done on product market risk than had been assumed at the outset of this research.

Research Question Three

What are the needs for a marketing based product market risk measure?

This questions was not specifically answered in any of the interview questions but several are related. The discussion of questions ten, twelve, and thirteen under research question two indicated some effort to look at product market information. The transcripts indicate that part of the problem is the time constraints and the lack of a conceptual way to integrate product market risk information into the models examined in chapter 3.

Those who used models tended to use the dividend discount model (seven out of twenty analysts), in which the direct input for risk is the discount rate chosen. The other models mentioned were CAPM (2), Low P/E (3), Proprietary (2), and Macro Economic Models (5). Those who used models stressed the convenience and structure.

Product market risk is most likely to be used in a decentralized system. Question four provides information about analysts' methods of

valuation. The major factors mentioned are shown on Table 20. Noticeably absent is any product market risk input.

TABLE 20
FACTORS IN VALUATION

Fundamental Analysis	17	85%
Earnings Focus	10	50%
Decentralized	9	45%
Macro Market	9	45%
Getting to Know Management	6	30%
Formula Approach	5	25%
CEO Doing Right or Wrong	5	25%
Risk	4	20%
Seeking Non-Consensus Position	3	15%

It is important to remember, when studying these nine items of the content analysis, that analysts could be classified under several different categories. Fundamental analysis is a review of the corporations, starting with the firm's basic financial statements, including the income statement and balance sheet. Fundamental analysis was appropriately mentioned by almost all analysts, seventeen out of twenty, as part of their valuation process. Fundamental analysis may be associated with the use of earnings to evaluate a firm's future strength (sixteen out of the seventeen also cited the earnings).

A second area of importance in valuation is the use of standard models or the formula approach. There were five respondents using a formula approach to valuation and they tended to mention models available in house, in particular the dividend growth model.

The third valuation area to be reviewed is earnings focus. This was

found, with one exception, on the buyside. What is remarkable are the things that were not mentioned by those using earnings focus. Some of their omissions are shown in Table 21. The number indicates the frequency (out of ten) that respondents mentioned the item. These items are significant to this study as they are some of the major areas that have to do with product market risk.

TABLE 21

ITEMS OMITTED BY THOSE USING EARNINGS FOCUS

1. Future Orientation in Relation to product market Customer Research. Those Who Have an Earnings Focus Did Not Mention Future Orientation When Asked about Product Market Customer Research.	0	0%
2. Technology, future, Oriented, in Relation to What Other Factors Impact Valuation Aside from Financial and Product Market Information.	1	10%
3. Product Market Risk as a Means to Evaluate a Firm's Future Strength.	0	0%
4. Customer Information in Relation to Product Market Customer Research. They Did Not Mention Researching: a. Consumer Information b. Kinds of Purchases c. Customer Preference Surveys	1	10%

The fourth area of valuation of concern was the structure of the valuation process: centralized or decentralized. Of twenty respondents, nine analysts mentioned a decentralized structure composed of: (1) Subjective, (2) Loose formula, and (3) Segment thinking.

The use of models did not appear in the content analysis of those nine analysts citing the decentralized structure, with the one exception that mentioned that the models were available in house. Decentralized evaluation would not be expected to be closely tied to models since it fosters individualization. It is in the decentralized structures that the most information about product market risk was found in the transcripts.

Risk was defined as the downside and upside potential, and was cited by four respondents. From the transcripts, It is interesting that respondents who mentioned risk seem to be looking at the big picture whether strategically or by looking at the product markets. They also had a future orientation and appeared to be interested in the product markets.

Nine respondents mentioned the macro market as part of the valuation process. The macro market situation was discussed as it impacted the financial markets as a whole. Macro markets are less a method of valuation then one of the component parts, whether subjective in the decentralized system or built into the model in the formula approach.

There were many other areas of valuation discussed by individual respondents but the ones listed seem to point to some of the major areas in valuation: risk, return, level of centralization, use of models, and fundamental analysis.

In response to research question three, there is a void in the area of product market risk both in terms of concept and practical application. The goal for question three was to find out what would be useful and why product risk was not considered more. What was found is that there are some efforts to include product risk into the valuation system. However, because of the lack of models, and as a practical measure, this only occurred as a subjective action in a decentralized structure and on a limited basis. It was also learned that the analysts' needs for efficiency and effectiveness are great and that a measure that does not meet these criteria is unlikely to receive wide success. That some analysts do spend the time it takes to do extensive product market research investigations is an indicator that the need to develop this area is recognized as a potential reduction of uncertainty.

Research Question Four

The final research question is: Can evaluation be explained solely by traditional measures?

Questions four, seven, eight, eleven, thirteen, and fifteen are relevant. In question four it was clear that analysts were using a variety of methods of valuation. That there was so much diversity would indicate a negative response to the question. The whole point of a non-consensus position is to find something that others have not considered. In other words, there may be some information bits that would help to reduce a portion of the uncertainty to its quantifiable form, risk. If this is so, the full valuation is not being explained by the current measures.

Question seven, attempts to elicit some of the models that are currently being taught in the academic community. When models were not mentioned in this case, it is significant, as the respondents were given several examples that could have aided their recall about what was available in their organization. It had been expected that there would be heavy use of the financial models available but only two areas seemed to surface in the content analysis: the availability of models in house (eight respondents), and the dividend growth model (seven respondents). Respondents using the dividend growth model tended to mention models available in house (six), and the formula approach, both expected (five).

It appears that model users have less interest in direct product market or customer information. This was supported by the information in the transcripts. It becomes evident that in the organizations which use models heavily that either the models are advisory or they dominate the system. In the case where they dominate the system the inputs to the models are basically available from readily quantifiable data, that being the source from which operational models have to be built. In the cases

where they do not dominate the system, models are used by individuals as checks and seem to be maintained by means other than the analyst's active input.

Five respondents reported that their firm had a specific macro economic model that was used to try and give structure to the input of macro market influences.

While some of the models used were very sophisticated, and some less so it was clear that not every analyst is using models. Many of the models were used as a combination as checks and balances. These combined forces at the most basic level indicate that evaluation can not be solely explained by traditional measures.

Question eight: How do you evaluate a firm's future strength?

This was a key question in the research. The goal of this question was to find out on what basis respondents made their decisions about a firm's future for the purpose of evaluation. There were a number of major areas that were mentioned by the twenty respondents as shown in Table 22.

The importance of earnings appears clear. It is also interesting that out of the sample of twenty there are sixteen that mentioned both earnings and fundamental analysis. Those focusing on the product market risk did not mention earnings, perhaps because they have a more future oriented measure in looking directly at the product markets.

While only three respondents cited financial market risk, seven specifically mentioned beta volatility. Beta is the traditional financial measure for risk and programs using beta are either used or are available at a number of the firms where interviews were held (seven reported beta volatility). Those who mentioned beta also tended to mention historical measures as a check in trend analysis. This has face validity since beta is

essentially an historical measure that indicates how a stock has moved or covaried with the market over a period of years. Respondents for beta volatility also mentioned having models available in house and obtaining research from the sellside.

TABLE 22

FACTORS USED IN EVALUATING A FIRM'S FUTURE

Content Analysis Term	Frequency
1. Return or Earnings	17
2. Beta Volatility	7
3. Product Market Risk Life Cycle	7
4. Product Market Risk Market Share	7
5. Business Risk	6
6. General Risk	6
7. Company Specific Risk	5
8. Industry Risk	4
9. Product Market Risk	4
10. Financial Market Risk	3

Business risk, mentioned by six analysts, and also general risk, will be discussed in detail in chapter six. Those who mentioned operating risk also tended to mention getting to know management, the use of secondary research as indicators of product market performance, and also respondents looking beyond the published statements. These appear to be logical if the analysts are really interested in the corporation. The idea of getting to know management and looking beyond statements particularly seemed to have merit. Several analysts mentioned that they actually did company visits, not only viewing operations but conducting in depth interviews with management on a variety of levels.

Product market risk, which is the focus of this paper, was mentioned directly by only four respondents. They looked in particular at elements of product market performance including product life cycle and product market share.

Four respondents mentioned industry risk, as a way of looking at the firm's future strength. They also mentioned the macro environment as a model, and industry opportunities and barriers. This appears to have face validity since respondents who used their own macro environmental assumptions, as opposed to those put in a model by someone else, also mentioned looking at the industry in trying to assess the firm.

The item of general risk, mentioned by six respondents, appeared to be associated with GAAP leading to a misstatement of earnings and the idea that since marketing costs are expensed instead of amortized, it may hinder long term investment in marketing. There was a considerable amount of discussion about these items in the interviews. It appears some analysts are looking behind the statements trying to understand what is impacting earnings in a structural way.

The final risk item to be discussed is company specific risk. Five of the respondents cited this item during their conversations. This, like operating risk, may be a surrogate for corporate performance which will be discussed in more detail in chapter six. Those who mentioned company specific risk also tended to mention product market risk: industry risk, barriers to entry, seeking a non consensus (free to explore corporate and product market) position and threats being better understood as a result of product market research. It seems that analysts looking at company specific risk are attempting to get more specific information in hopes of finding something that will allow them to feel comfortable in taking the non-consensus position. In conclusion, the analysts cited a number of

different risk measures. These risk measures might be grouped in three areas.

1. Financial Risk
 - a. Return or Earnings
 - b. Financial Market Risk
 - c. Beta Volatility
2. Corporate Risk
 - a. Operating Risk
 - b. Industry Risk
 - c. General Risk
 - d. Company Specific Risk
3. Product Market Risk
 - a. Product Market Risk -- Life Cycle
 - b. Product Market Risk -- Market Share

These three areas will be developed later into a model that relates them all. It had been hoped to find more information about product market risk. It was not, however, forthcoming from the analysts in their own terms for a number of reasons—including the number of other variables that analysts have to look at.

Question eleven: How do you use historical firm and industry product market performance measures?

There were eleven cases where there was an affirmative indication that such measures were used and in almost every case the discussion revolved around using this information as a check in trend analysis. Those analysts also tended to mention beta as a measure of volatility. While at first this might not appear to make sense, the beta measure is a trend measure. Apparently a number of analysts are using traditional product market measures when they are available but not as a product market risk measure. This is evidenced by the thirteen respondents that look at market share in the second item in this question.

Question thirteen was discussed under research question two and indicated that some analysts did look at the product market.

Question fifteen: What other factors impact valuation aside financial and product market information?

There are four major content items in this area. The first one is management of the corporation. Management was cited as one of the additional factors that respondents look at in seventeen out of twenty cases. This appeared to be particularly important in small and medium size firms. It is interesting that management appears to be mentioned by those focusing on historical measures and not mentioned by those looking at product market risk. It may be that if the product market is being considered then that implies a more in depth look at the whole operation than those who also look at management in addition to financial market information.

The second content item is looking at technology as an indicator for the future (mentioned by seven respondents). This appeared to function as a surrogate for research and development and a part of market investment. Analysts who mentioned technology also mentioned short-term horizon for the firm, sellside, longer term analyst focus, misstatements caused by GAAP, and analysts looking beyond statements.

Of interest is the appearance of the longer term focus of the analyst with shorter term focus of the firm in valuation. This may be because most of the brokerage houses seem to have shorter term focus while the brokers who were looking at product markets seem to have longer term horizons themselves. The long term focus of buy-side firms seems to come with the use of models.

The third area is the macro environment. Ten out of the twenty mentioned looking at the macro environment as an additional item because of its overall impact in all financial markets. The fourth area is products and customer research and ten respondents also mentioned it. There are at

least ten looking forward to trying to understand change and risk in the product market as it will impact the financial markets. If the sample is representative this indicates that fifty percent of the analysts need available, and would like, a measure such as presence.

Question sixteen: Does our accounting system hinder management from taking a long term view of the firm.

Again there were four content items that developed. The first item was the misstatement of reported corporate earnings caused by GAAP, mentioned by four analysts. This particularly was connected with reduction of earnings by amortization and inability to amortize marketing expenses (eight respondents). Five individuals responded that they thought management was generally conservative in the use of GAAP. Eight respondents felt that they and other analysts look beyond accounting statements and therefore changes in GAAP should not impact valuations. Finally one analyst felt that accountants and lawyers hinder the understanding of the true value of everything. There was a clear indication among the sample that GAAP impacts earnings. The question is what is, the impact? Everyone recognized the need for something like GAAP to provide a system but there is need to look beyond that system and understand what, if any, distortion it may cause and what options are available to management under GAAP such as adjustments in reserves, write-offs, and so forth.

Question seventeen: Since marketing costs are expensed are long-term market investments hindered by our valuation methods?

Four of the respondents replied "no". This appears to be negatively associated with looking at product market customers and the macroenvironment. Two discussed the idea that the expensing of marketing items may impact the timing and growth of sales. Five

mentioned that the investment community will make its judgement based on the reasonableness of the strategy -- if the strategy is known or ever discussed with its members. Five simply responded "yes," that they felt the expensing of market investments hindered long-term market investments. The collective impact of decisions made in strategic business units may not be seen or understood by the financial markkets for some time.

In response to research question four, analysts are looking at too many other things for their valuations to be solely explained by traditional measures.

Conclusion

In summary, the type of qualitative interviews that were done do not provide the material for hypothesis testing. It has provided a great deal of material for explanation and development of understanding of how the product markets and the financial markets may be related. This will be fully developed in chapter six, using the information in this chapter and the material from the transcripts. It is interesting that while several have wrestled with the problems of product market risk, not one of the analysts had developed any specific way of quantifying it for transfer into the financial markets.

The material presented here should give the reader some idea of the kinds of things that were found and some of the relationships that appeared to exist from the twenty interviews. To move much beyond the development of an explanation with the research available would be inappropriate. It is hoped that further research will be encouraged by the model developed in chapter six.

CHAPTER SIX

THE IMPACT OF PRODUCT MARKET RISK

Development of Model

As this research began it focused on the development of a product market risk concept. Products, like people and corporations, develop a reputation for good and bad. It has always been recognized that product and corporate reputation (brand image, and so on) are important in marketing and in the financial markets. But how important it is and how it is to be used in marketing strategy to maximize results are significant questions. Reputation is defined as "overall quality or character as seen or judged by people in general," (Websters, 1976, p. 983). It is believed that a set of elements of this generality can be measured, explained, and exploited in marketing strategy. This has been labelled presence. Some of the elements of presence are:

1. High awareness with customers
2. Appears frequently in the of evoked sets of potential customers
3. Serves as the standard for the product class, among current and potential customers
4. Name is used in a generic context by current and potential customers

Presence was thought to influence product market performance directly and, through its impact on product market risk, to influence financial market performance. A simplified illustration of this linkage is shown in Figure 12. In this iteration, presence's influence on the financial market was expected to be generated from the power it would create in the

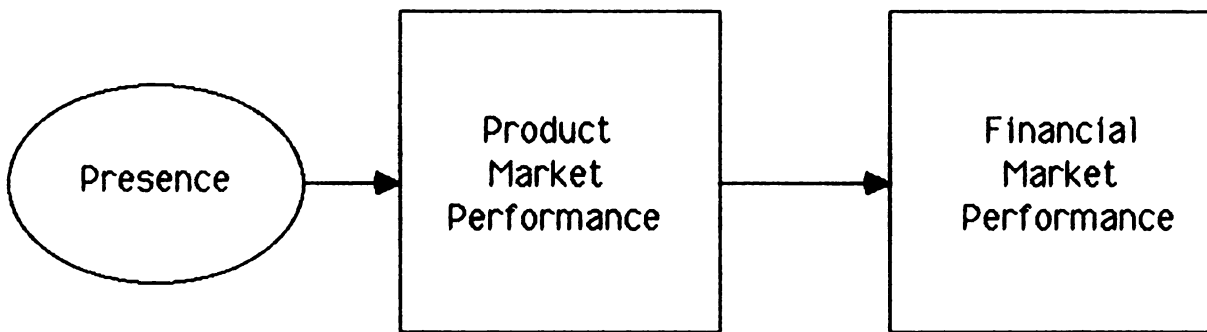


Figure 12

PRELIMINARY PRODUCT-FINANCIAL MARKET LINK

product market. It was thought that if a product had a high degree of the characteristics of presence then this would indicate future strength in sales for the product market. This would imply higher earnings and reduced risk which should lead to better financial market performance.

The next stage in the evolution of the concept showed presence modifying both product market performance and financial market performance directly. (see Figure 13). This iteration evolved because some of the early information provided by financial analysts indicated that, while they did not really have any product market measures, there was certainly a general look at company product strength to develop an estimate of earnings for the future (F1). This model attempted to show that presence, as perceived by customers, had a direct influence on the company's performance in both the product and the financial markets.

The importance of corporate financial performance became clear as the research developed. From the point of view of analysts in the financial markets, corporate performance and the performance of the firm's strategic business units (SBU), from which the corporate performance is in part derived, clearly act as a filter that tends to obscure the linkage between product market performance and corporate financial performance (see Figure 14).

In the final iteration it evolved that there are three areas of risk: (1) Product Market Risk (PMR), (2) Company Specific Risk (CSR), and (3) Financial Market Risk (FMR).

In each of these areas, presence as a concept may help to understand product and financial market risk. Risk, by definition is quantifiable, unknown future events (Knight). Product market risk is a function of customers' perceptions up to the point of sale; sales become history as

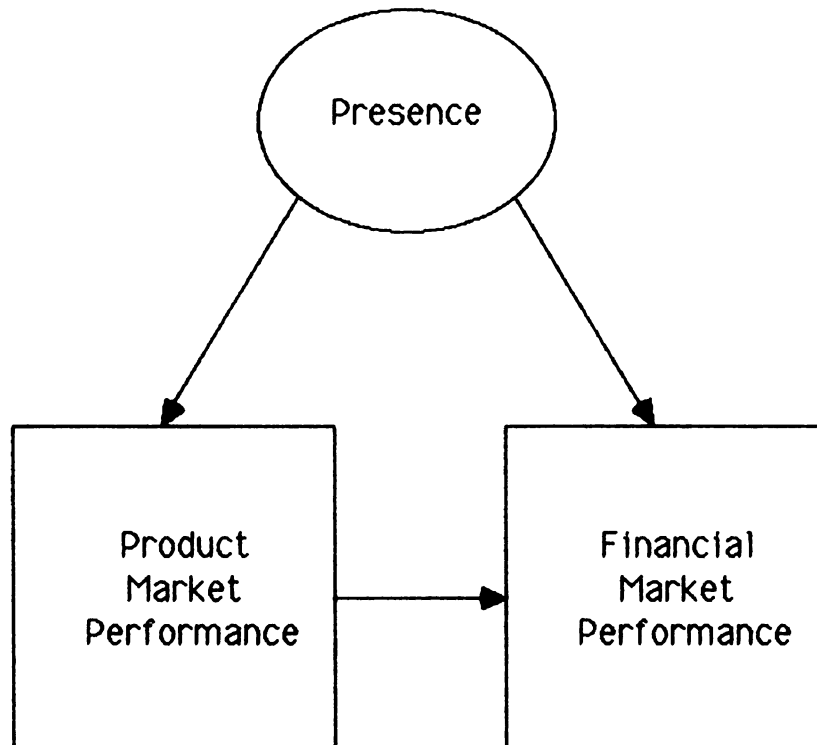


Figure 13

REVISED PRODUCT-FINANCIAL MARKET LINK

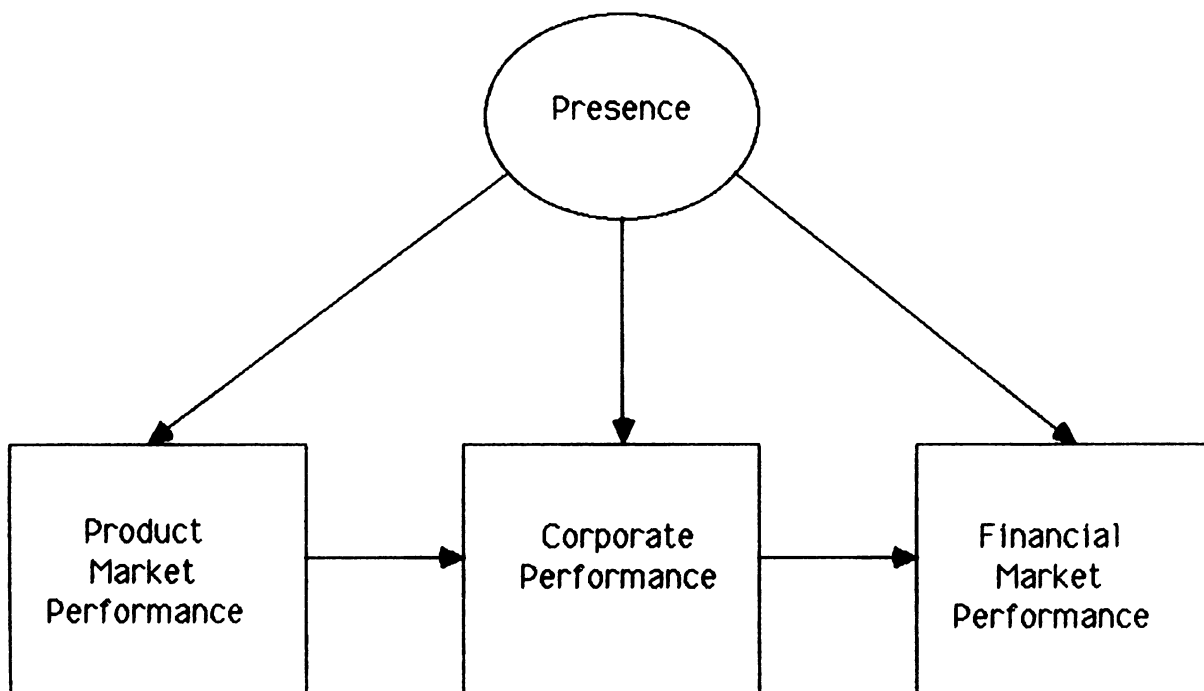


Figure 14

FURTHER REVISED PRODUCT-FINANCIAL MARKET LINKK

soon as they occur. Company specific risk encompasses everything from sales to determination of corporate earnings. Financial market risk encompasses all the factors that can impact the performance of the stock in the financial markets or, "evaluating risky monetary flows or values over time," (Haley, 1979, p. 1).

The development of these three areas will be handled from the top down: (1) financial market risk, (2) company specific risk, and (3) product market risk

What is described is the relationship of the product market's performance and financial market's by way of corporate performance. This relationship was explored in order to expand the understanding of the impact of product market risk. It is because of this larger model that it is possible to understand why the financial market performance is not a direct derivative of the product market performance. It also helps to understand the importance of the product market risk concept to both finance and marketing (see Figure 15).

Relating Product Market Performance to Financial Market Performance

It is important to understand the relationship between product market performance and financial market performance if marketing managers are going to participate in planning overall business strategy. This understanding becomes all the more important if the goal of the firm is maximization of shareholder wealth. The problem is to conceptualize how product market accomplishments are translated into changing stock prices.

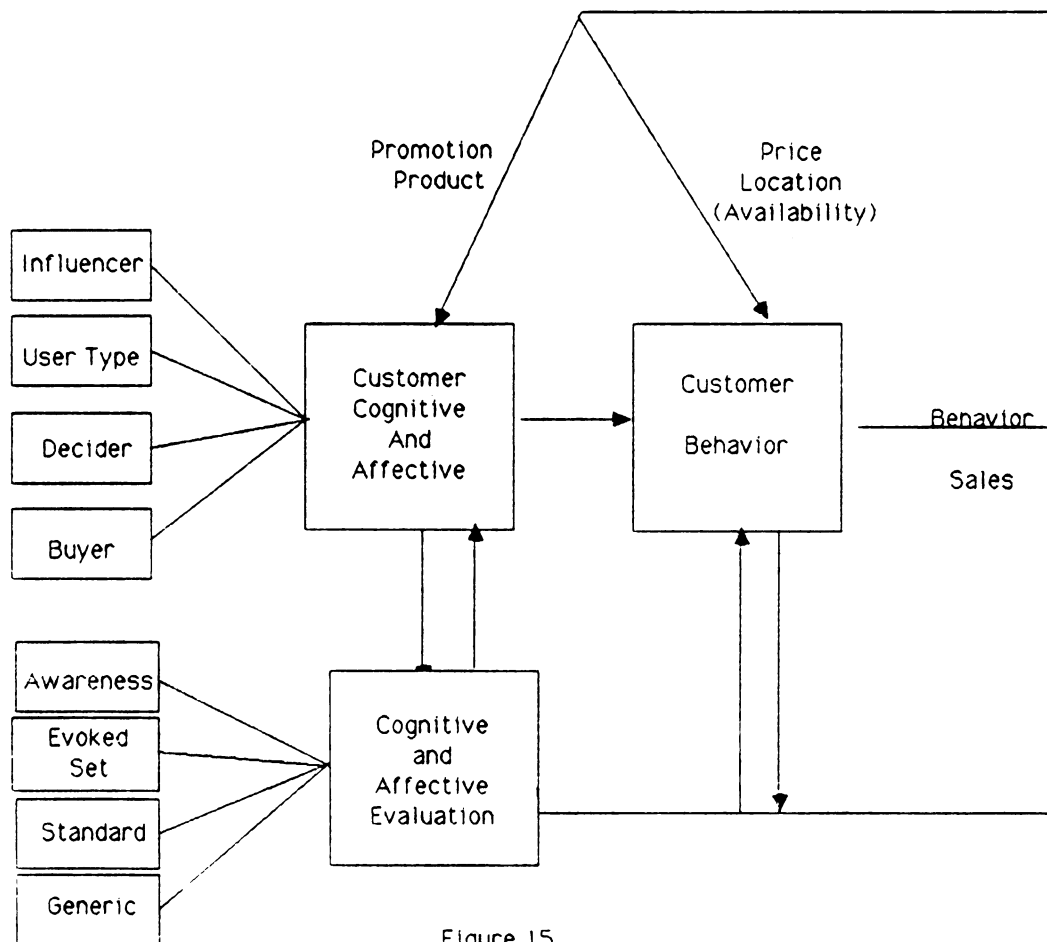


Figure 15

Product Market Risk

Relationship of PMP and FMP

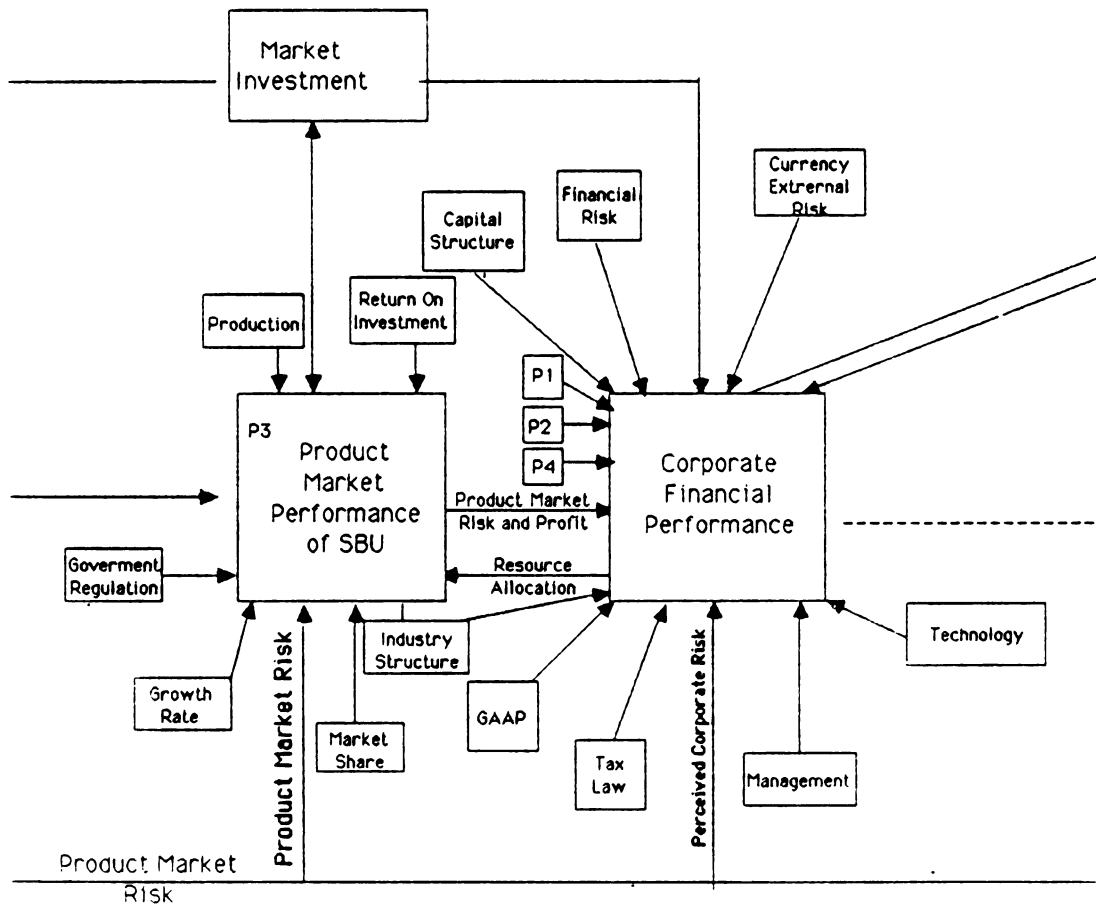


Figure 15 cont'd

Company Specific Risk

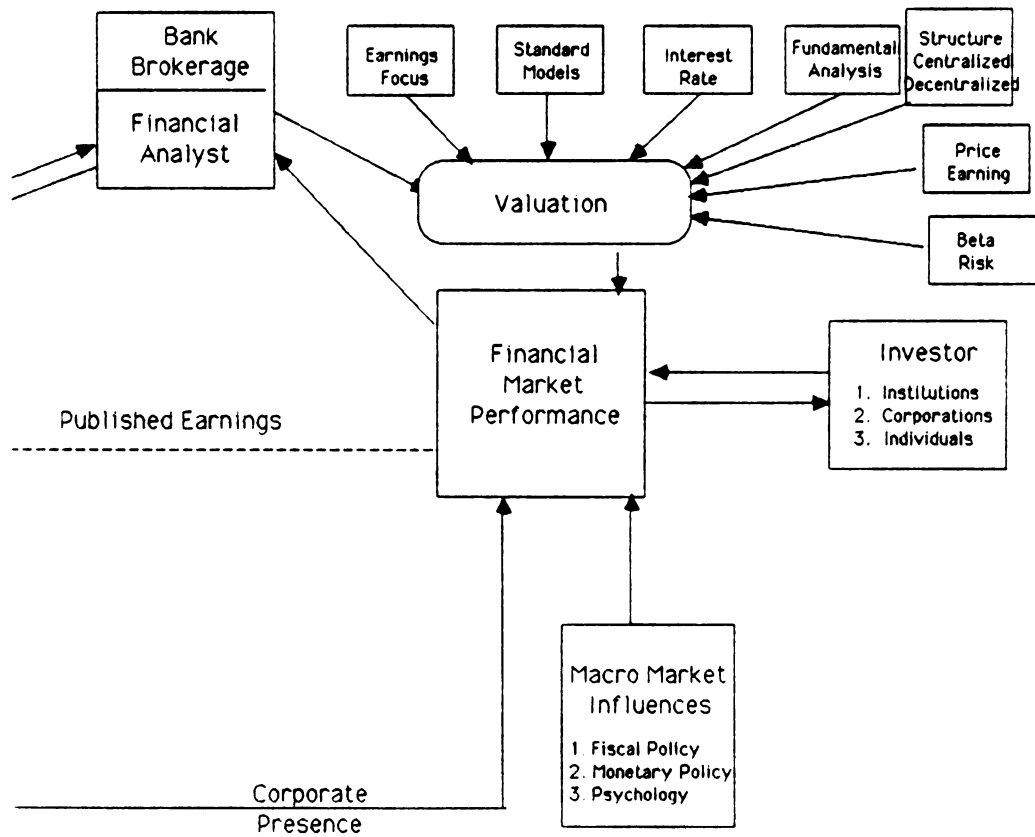


Figure 15 cont'd

Financial Market Risk

-Financial Market Performance

It was originally stated in chapter one that product market performance should be reflected directly to financial market performance. It turns out that the relationship to the financial market is far more complex than originally considered. There are so many major variables close to the financial market that affect the prices of securities that what is transpiring in the product market place may appear to have little impact.

Two major elements of the complexity of the financial market place are macro market influences and investor objectives. The analysts made it clear that macro influences are very dominant in their approaches to valuation and therefore force other information on product markets to be subordinated to the macro market influences. Three areas of macro market influence that are dominant are: fiscal policy, monetary policy, and market psychology (see Figure 16).

Fiscal policy plays a large role in a market system because many tax and spending decisions by the government have a major impact on the financial market. For example, a change in the capital gains tax rate can significantly impact decisions on whether to hold, sell, or buy securities. Even more importantly, the length of time a security must be held to be eligible for capital gains will impact the market. It appears that the holding period horizon does not affect the valuation period horizon.

The government's decision on where to spend its resources also directly impacts the market. The announced plan to build defense has had a substantial impact on the financial market in defense stocks and many other related areas. The financial market can reasonably forecast the behavioral action on the part of the defense department (the customer).

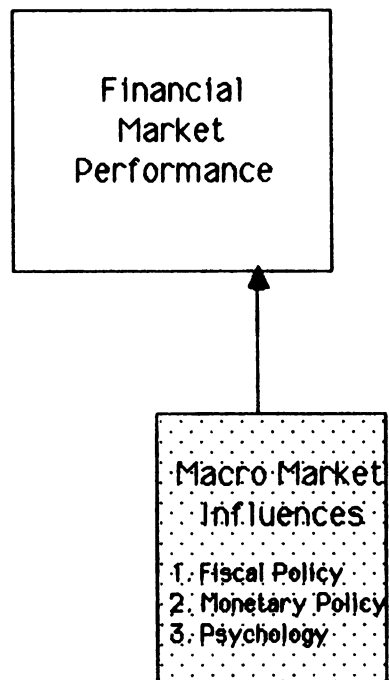


Figure 16

Macro Market Influences



Increased sales throughout vertical defense industry channels means an expanding market throughout the related system of subcontractors and suppliers.

Monetary policy and the rate of interest also has an important impact on the financial markets. Evaluations are made on the basis of risk and return. What the government pays for the use of money in the form of Treasury bills is the "risk-free" rate. Changes in the "risk free" rate, adjusted for inflation, can impact what investors and money managers believe the value of stocks will be in the future. An investment, by definition, has a return component as well as risk. If, because the cost of money declines, the expectation of return rises while risk remains constant, then the stock price will rise. This is oversimplified but it makes the point that the investment community watches the monetary policy closely. The actions of the Federal Reserve Board are very important to Wall Street as they impact the financial markets directly. There are a number of tools that the government has available to influence monetary policy. These include: the raising or lowering of the discount rate, the rate it will pay for or sell money for, and, in combination with the Treasury, how much money is being printed.

Monetary and fiscal policy are big influencers of the financial markets and their impact has been well documented in the finance discipline. Unexpectedly, several analysts considered market psychology to be a major influence in the financial market place.

Market psychology is very sensitive to rumor. This is information that spreads through the networks on the street very rapidly and motivates the movement of billions of dollars. The stakes are high in the financial markets and, because they are a near perfect market, they are almost

immediately decided. Despite all the tools that are available to carefully analyze what is the best investment value, analysts and portfolio managers who are active in the financial markets were intensely interested in rumors. Considering the size of the portfolios for which they are responsible, it is evident that any piece of information, real or fictitious, is important. It may help explain what is occurring in the performance of any stock, or to portend a price movement.

The goal of most managers is to do at least as well as other money managers and, if possible, to do better. To maintain their jobs, managers must perform with the market (Graham, The Intelligent Investor). There is little allegiance to the stock of one company. The goal is the highest total return with the least amount of risk. Bonuses are often based, in part, on outperforming the market. In the weak form of the efficient market hypothesis, the impact of rumors is particularly high because of the variance among analysts in reaction time necessary to determine credibility and effect.

Rumor can come from any number of sources and can take a number of forms. Rumor is not only a "hot tip" about one company but it could be about some macro environmental force that may impact an industry or the whole market. The sources can include the company, the industry, Wall Street, or the political arena. When one is dealing in tens of thousands of shares of a given stock, any rumor that may influence a buy-sell decision, enough to cause a small price blip can mean substantial profits if acted upon with the proper timing.

Other macro factors that influence the Financial Market Performance include demographic trends, catastrophic events, major changes in the balance of power in world political events, and so forth.

-Investor Objectives

Investors are classified in a number of different ways:

1. Size
2. Nature of Return Desired
 - a. Income (Current, Future; and Taxable, Nontaxable)
 - b. Capital Growth (Short-Term, Long-Term)
3. Investor Type
 - a. Institutions
 - b. Corporations
 - c. Individuals

The most common classification used was investor type (see Figure 17). One of the surprises of this research was the very short term holding periods and very high portfolio turnover of the main participants in the financial market place. The overall short term nature of institutional and corporate investing impacts the performance of individual companies in the financial markets, as it tends to reflect constantly in market evolution the latest information and rumor.

All three kinds of investors put information and resources into the financial market place, as well as receive information and resources from it. Perhaps most important in terms of later strategy is the short term holding period of many of the investors. Previous to this research the author had made the assumption that when the phrase "maximization of shareholder wealth" was used, the long term was the relevant period. It may be that the technique of analysts and professional arbitrageurs is to estimate long-term risk and potential by discounting the more readily apparent short-term predictions. This would make the short-term focus more closely allied with traditional longer term assumptions that are used in many discussions. This technique ignores the impact of increasing or

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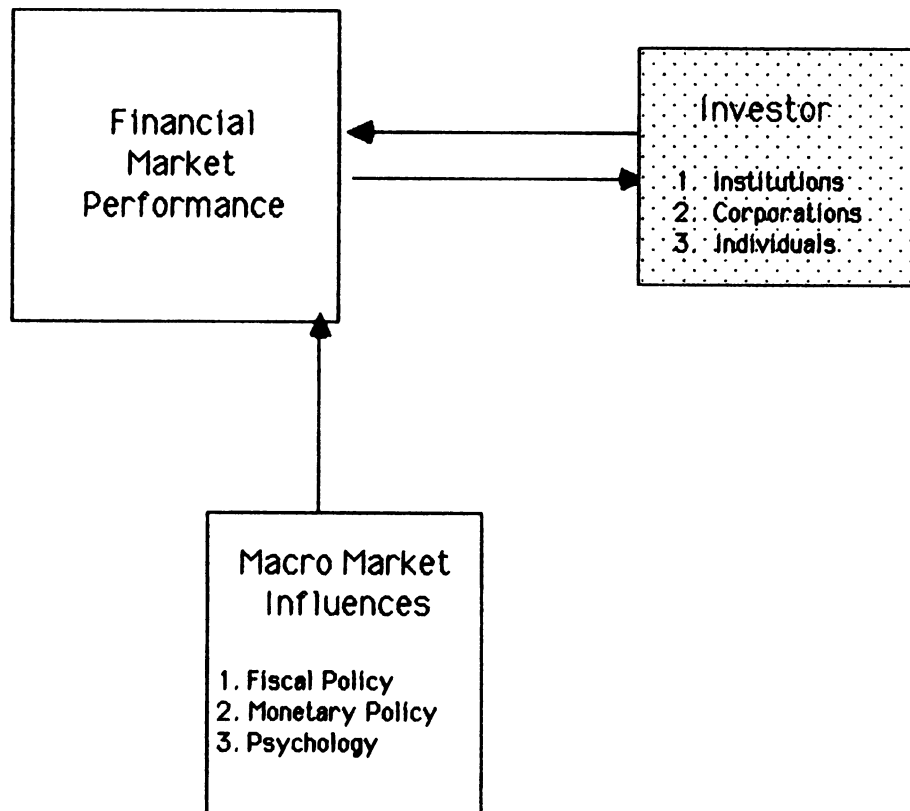


Figure 17

Investors

decreasing product market risk, since this discounting generally only recognizes product life span and the macro influences. The analyst is unlikely to incorporate product market risk or other long-term concepts until provided with an expedient method of obtaining this information.

In chapter one, the idea of two to five year horizons for investment was discussed. The analysts interviewed indicated that they accepted the concept of maximizing shareholder wealth but that their horizons were very short term. In several cases it was admitted that, on occasion, stocks were held for as short a period as a few hours (E2). These portfolio changes could be industry (class) changes as well as shifts between individual firms within an industry. The short term horizon for the maximization of shareholder wealth appears to dominate the market due to:

1. The large amount of capital held in tax deferred pension funds not subject to holding period requirements
2. The need for portfolio managers to stay with the market or improve on it as a basis for their year end compensation
3. The results of portfolios being managed according to models

The model based portfolios compute values below which a stock should be bought and above which they should be sold. When the market price reaches this value the process of purchase or sale of shares is automatically triggered.

The institutional investor has a much more flexibility when managing pension funds or charitable trusts a when managing individual trusts and or corporate funds, which are subject to more immediate taxation. Corporate funds are usually more flexible than individuals. Individuals

are the least flexible because they usually do not have the current information necessary to trade frequently. Even though information moves quickly, individuals are the last to receive it (see Figure 18). Even the banks with substantial individual trusts indicated that frequently trust investments are tied up in specific companies which, because of sentimental values and tax impact, are not easily bought and sold. It is important to remember that every investor is basically looking for condition of low risk and high return. The concept of presence is focusing on low risk. Longer term investors are more likely to be concerned with product market risk as it will have an effect on the more distant horizon. The short-term investor will see the impact of the implied effect of product market risk on immediate price.

-Analysts Do Not Focus on Product Markets

There are many factors that help to explain why financial market performance is not more directly tied to product market performance. The analysts themselves have two very different approaches depending on who employs them. The two major classifications are buy-side and sell-side. Buy-side analysts work for banks or other institutions whose principal income comes from the management of money. They are called buy-side because, as they or their portfolio managers buy, they have the ability to create commissions for the brokerage houses or sell-side. Buy-side analysts often follow larger groups of firms or whole industries. Based on the qualitative research conducted they have a heavy earnings focus.

The sell side analysts work for institutions whose income is generated from commissions received for information and brokerage. Sell-side

The short-term interest rate is the rate of return on a riskless investment, which is the opportunity cost of the product market. The short-term interest rate is the rate of return on a riskless investment, which is the opportunity cost of the product market. The short-term interest rate is the rate of return on a riskless investment, which is the opportunity cost of the product market.

—Avalista do not Focus on History, 1988:23

Based on the qualitative research conducted there have been a number of key findings that have been identified. Buy-side analysts often follow a wider group of sources with a view to creating a comprehensive picture of the company and its performance. They are able to do this by creating a network of sources from the management of companies that will provide them with the information that they need to write their reports. The two major types of information that they use are company financials and company performance. The two major types of information that they use are company financials and company performance. The two major types of information that they use are company financials and company performance.

56.11

The self-side analysis was the first iteration, where a common set of

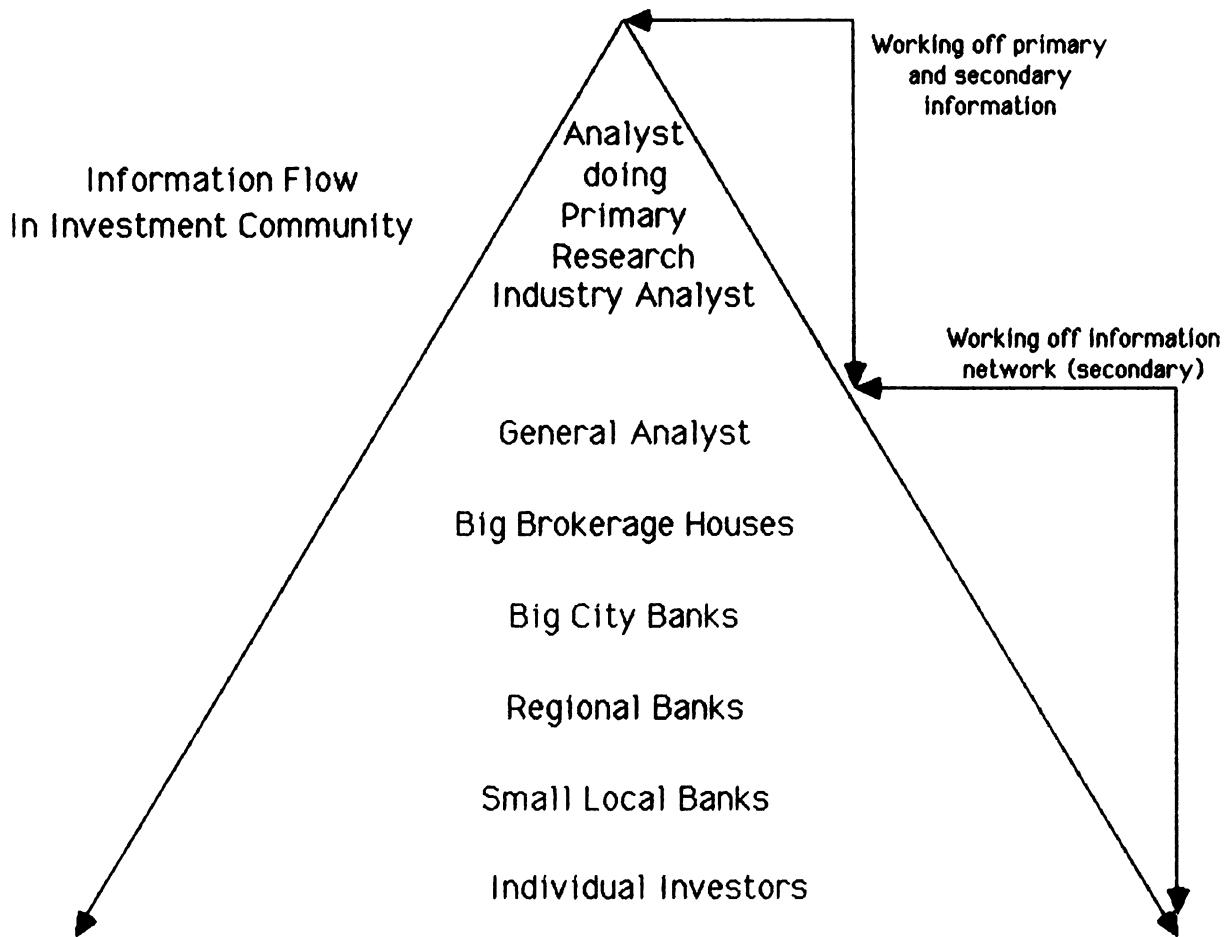


Figure 18

INFORMATION FLOW IN INVESTMENT COMMUNITY

analysts are usually specialized to following a very small set of firms. Collectively, both the buy and sell analysts have a dramatic influence on the performance of financial markets as they make the valuation decisions and resulting buy-sell or hold recommendations. The investment goal is to perform at least as well as the crowd (the consensus) on a period-by-period basis.

The overriding need to stay with the market in the short term may lead analysts and portfolio managers to concentrate on immediately available information including financial market psychology, rather than on longer term aspects of risk and return. To stay with the crowd, analysts become less concerned with economic substance and more concerned with the perceptions of their colleagues (market psychology). Analysts have two constraints, time and information. To be useful, information must be effective, timely and meaningful within the horizon.

In addition to having an earnings focus, buyside analysts tend to approach the valuation using short-term fundamental corporate analysis starting with the balance sheet and income statement. Often they will use the information provided in corporate reports and other published information about the firm. This seems to be as far toward the customer and the product market as they go.

Analysts use models in a number of different ways. At some institutions, the analyst primarily puts estimates into models such as growth rate for the next five years for the dividend growth model or adjusting an alpha based on their knowledge of a firm. Beyond that, the models, usually a dividend discount model or low P/E model, generate the buy and sell levels for all stocks. In some cases the portfolio managers were supposed to hold the optimal portfolio (E2, M1, C1). A middle

position would find the knowledgeable analysts using models as a check on their other estimates. A third group of analysts hardly use models at all and are not really interested in models even as checks.

The heavy use of models has certain impacts on the organizations using them. Model usage tends to lead to high portfolio turnover, particularly in a volatile market, as new sell and buy levels are continuously reached. The true model user will continually adjust the portfolio, particularly for accounts for which taxes are not an immediate consideration. This model dependence tends to discourage any long-term approach to stocks and promotes focusing on the most immediate variables that are in the financial market place and how they will impact the price of individual securities. Thus, there is little concern with anything behind the corporation's immediate earnings. There is little, if any, product market risk consideration and little customer research. The only way the product market position would work into the model would be if the corporate management of the firm could persuade analysts that, because of presence, a growth rate above normal could be expected. This is not done, in large part, because marketing currently contains no measures of product market risk that are timely and easy to understand.

Another reason why financial market analysts do not focus on the roots of income in the product markets is the wide variation of education and experience in analysts. Analysts have found their way into their jobs with a number of different backgrounds. The business school graduates tend to have been schooled in finance, which emphasizes the corporate financial structure.

Another factor that impacts the quality of the analyst's work on an individual company is their concentration. The work levels varied from

one analyst following a few companies to one bank where two analysts are responsible for following the whole financial market (C1). Those analysts who are expected to cover whole industries could do little more than keep up with published information. The innovative and creative people looking at the product markets were covering sections of industries (P1,F1, L1, and K1).

The valuation structure of the organization in which analysts work also has a major impact on analysis. Some organizations are highly centralized and every analyst must use the same method. Any deviance must be explained and justified to a committee of peers. Centralized structures appear to go along with a heavy dependence on models for actual portfolio management. The strategy, then, is to use the model and everyone in the organization is expected to go along. Many of these analysts miss the opportunity to look beyond the corporate published documents at any kind of product market risk. They use what they are familiar with. The organizations tend to use top down models starting with the macro environment. This is logical: in many of the models the macro assumptions will have more direct impact than shifts in the assumptions on the micro level.

In contrast, some organizations use a decentralized method of valuation. This means that analysts are free to use any approach they wish-- including speculating on scenarios (G2). This tended to exist most in banks where the portfolio managers were independent of the in house analyst and could use the recommendations of those analysts if they wished or they could go outside for other opinions (H, G). The advantage of this system is that it creates an opportunity for exploration. Such exploration tends to enlighten the research as analysts attempt a better

1. The first step in the process of identifying a problem is to recognize that a problem exists. This is often done by comparing current performance with a desired state or goal. For example, if a company's sales are declining, it may indicate a problem with its marketing strategy or product quality.

2. Once a problem is identified, the next step is to define the problem more precisely. This involves determining the scope of the problem, its causes, and its effects. For example, if sales are declining, it is important to determine whether the decline is due to a change in customer preferences, a new competitor, or a problem with the company's own products or services.

3. The third step is to generate potential solutions. This can be done by brainstorming ideas, consulting with experts, or researching best practices. For example, if sales are declining due to a change in customer preferences, potential solutions might include developing new products, improving customer service, or adjusting the pricing strategy.

4. The fourth step is to evaluate the potential solutions. This involves comparing the benefits and costs of each solution and determining which one is most likely to be successful. For example, if the potential solutions are developing new products, improving customer service, or adjusting the pricing strategy, it is important to evaluate the costs of each solution and the potential benefits to the company.

5. The fifth step is to implement the chosen solution. This involves putting the solution into action and monitoring its progress. For example, if the chosen solution is to develop new products, it is important to ensure that the new products are developed and marketed effectively.

6. The final step is to evaluate the results of the solution. This involves comparing the actual results with the desired state or goal and determining whether the solution was successful. For example, if the chosen solution was to develop new products, it is important to evaluate whether the new products have increased sales and improved customer satisfaction.

understanding of what the future might look like by focusing more directly on the product markets usually through purchased research (IMS, Gartner, Nielsens, and so on). Figure 19 shows the impact of valuation of standard models, fundamental analysis, and the structure of valuation-centralized or decentralized.

There are a number of different valuation methods used by analysts. This is not meant to be a complete discussion of methods of valuation but rather an indication of what is actually being used in the field based on the sample for this research. Among the more regional banks, including the Chicago banks, there was clearly an earnings focus. This was demonstrated in use of the low P/E (price to earnings ratios) and the dividend discount model.

The low P/E model was used by one regional bank. It essentially reduced the universe of stocks down to a small portfolio of sixty to seventy stocks with low P/E's. The theory behind this model is that the investor gets a better return for less risk than could be obtained through other combinations of securities. In other words, people who follow the low P/E model must believe that the financial market has assigned too high a risk level to the earnings. Since earnings are public knowledge, the market accurately reflects earnings. Risk is the more subjective component. One reason why risk might not be accurately reflected is that product market risk is a component but there are no measures and little discussion of how to apply product market risk information in the financial markets.

Another valuation method that is heavily earnings focused is the dividend discount model which was found in a number of different banks (E2; J1;H2). Basically this model has three periods: years one to five,

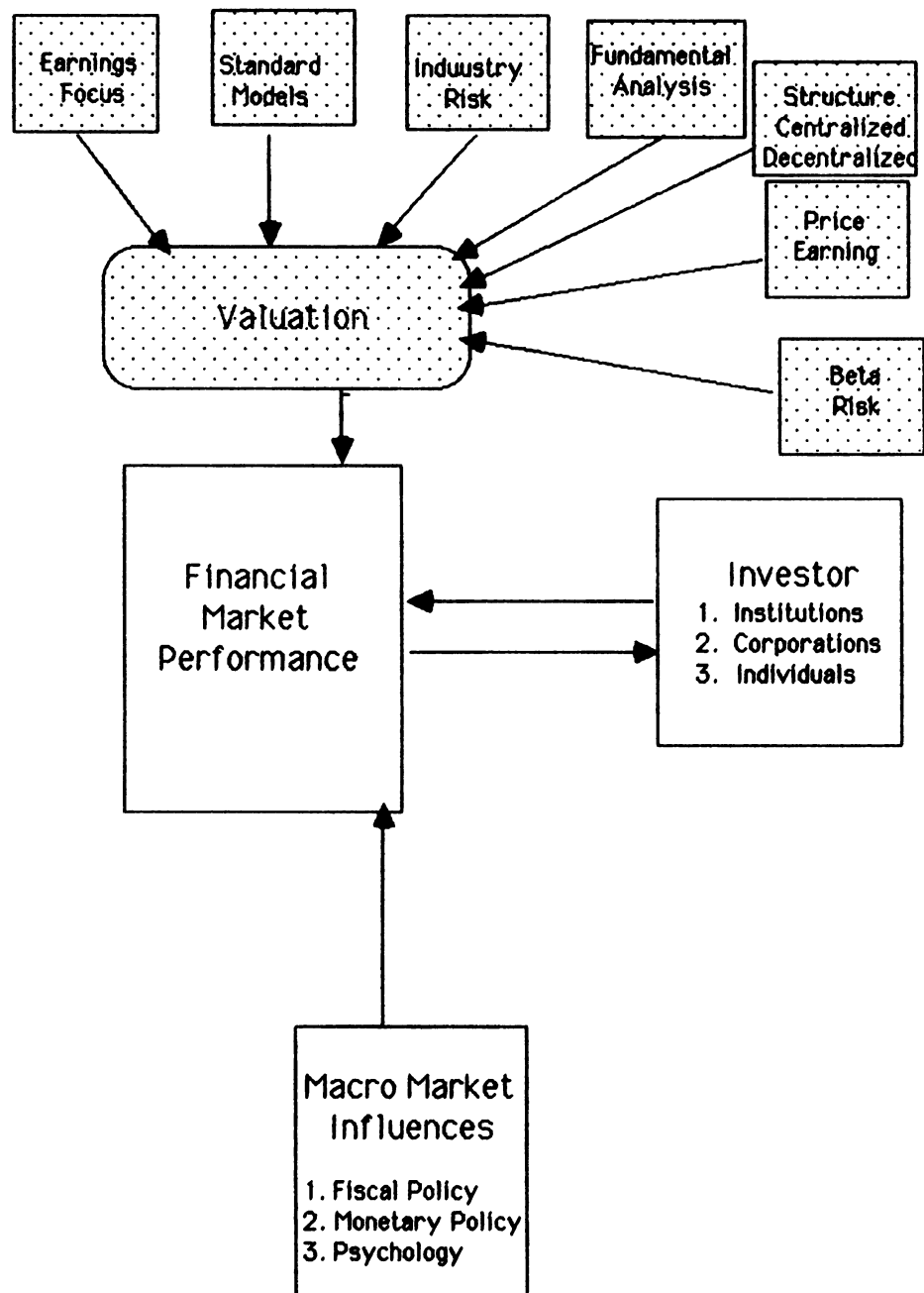


Figure 19
VALUATION FACTORS

years six to ten, and years eleven to fifteen. It is generally assumed that companies cannot earn excessive returns for more than one period, one to five years. If they do, they will attract competition and lower their earnings and return. The dividend discount model basically says that the value of the stock is the present value of the income stream it offers plus any liquidating dividend. Dividends are earnings dependent; therefore, so is the model (see Figure 20).

To give some insight into the model it may help to understand how it is used. At one midwest bank, all investment decisions were based on the dividend discount model (E2). Analysts could influence the model by the length of time they predicted excessive earnings, usually between three and seven years. At another bank in New York, the analyst felt that only the first five years were relevant and that beyond that was too far in the future (H2).

The dividend discount model focuses on earnings and the length of time a firm may expect to have excessive earnings.

In addition to low P/E and dividend discount models, there are a number of other standardized models that are available to many analysts. These are used as checks and can be helpful in developing a case for a different position (non-consensus) from that which would be indicated by market psychology (consensus position). These include, but are not limited to:

1. Return on Investment
2. Earnings Growth Rate
3. P/E Relative
4. Market to Book
5. Price to Sales Ratio (Fisher, 1984)

Industry risk is also considered a factor in valuation in some cases. ,

any lipidated divalent. The lipid and ethanol deposited on the side of the slide, the lipid content of the sample was determined by the method of Folch (1956).

the first time they were used in a laboratory setting. The first time they were used in a laboratory setting was in 1971, when they were used to study the effects of stress on the immune system. Since then, they have been used in a variety of other studies, including studies on the effects of stress on the cardiovascular system, the respiratory system, and the digestive system. They have also been used in studies on the effects of stress on the nervous system, the endocrine system, and the reproductive system. In addition, they have been used in studies on the effects of stress on the immune system in various animal models, including rats, mice, and monkeys. Finally, they have been used in studies on the effects of stress on the immune system in humans, including studies on the effects of stress on the immune system in healthy individuals and in individuals with various medical conditions.

The dividend should not be paid if the company is insolvent or if the dividend would be paid out of capital.

psychology (condensed version). These included a 10-item self-report position (non-exhaustive) from 1 of 4 items (word list, drawing, drawing position) and a 10-item self-report position (non-exhaustive) from 1 of 4 items (word list, drawing, drawing position) and a 10-item self-report position (non-exhaustive) from 1 of 4 items (word list, drawing, drawing position).

The basic formula with no growth:

$$\text{Price} = \frac{\text{Dividend}}{\text{Capitalization Rate}}$$

or $P_0 = \frac{d_1}{K_S}$

Constant growth rate:

$$P_0 = \frac{d_1}{K_S - g}$$

Period of super normal growth:

$$P_0 = \sum_{t=1}^n \frac{d_0(1+g_S)^t}{(1+K_S)^t} + \frac{(d_{n+1})}{(K_S - g_n)} + \frac{(1)}{(1+K_S)^n}$$

Here period "N" is the period of super normal growth, g_S is the supernormal growth rate, and the normal growth rate is " g_n " (Weston and Brigham p. 648, 1978).

Figure 20
DIVIDEND DISCOUNT MODEL

In many cases the firms are too much of a conglomerate for industry to have much meaning (B1). It may have more meaning on the product market level. Where strategic business units are in a defined industry this certainly impacts valuation. This was particularly noticeable in the drug industry where the impact of patents provides such long life cycles that they become an industry characteristic (K1). It was also seen in the computer area in the approach the Gartner group took to evaluating securities (L1). In some industries there are services that specialize in evaluation of firms, products, and trends. Where this is available it may provide the tools to evaluate industry risk.

An evaluation method that was repeatedly mentioned was the basic P/E ratio and the P/E relative. High multiples tend to indicate expectations of substantial growth expected, or greatly reduce risk. Whether high multiples reflect reduced product market risks is uncertain because of the number of other factors involved. It is clear, in the newspaper industry, that the high multiples existed because of the reduced risk in one of the two product markets they service: newspapers readers and advertisers. Newspapers are, to some degree, an economic franchise or monopoly as far as the reader base goes.

As shown in Figure 21 there are a number of factors and techniques which affect the various analysts' valuations, which in turn impacts their buy-sell actions, and thus the financial market performance of the security. These factors make up financial market risk. The changing market price affects the models and the analysts' resulting recommendations in a constantly adjusting system. In general, product market performance only enters into the financial evaluation as an historical base for projections.

Two female members of the same family were found in the same area. The first was a young female, and the second was an adult female. Both were found in the same area, and both were found in the same area. The first was a young female, and the second was an adult female. Both were found in the same area, and both were found in the same area.

As we indicated in the previous report, the results of the study suggest that the use of the VAS for assessing the relative importance of the various factors is a valid method. The results of the study suggest that the use of the VAS for assessing the relative importance of the various factors is a valid method. The results of the study suggest that the use of the VAS for assessing the relative importance of the various factors is a valid method.

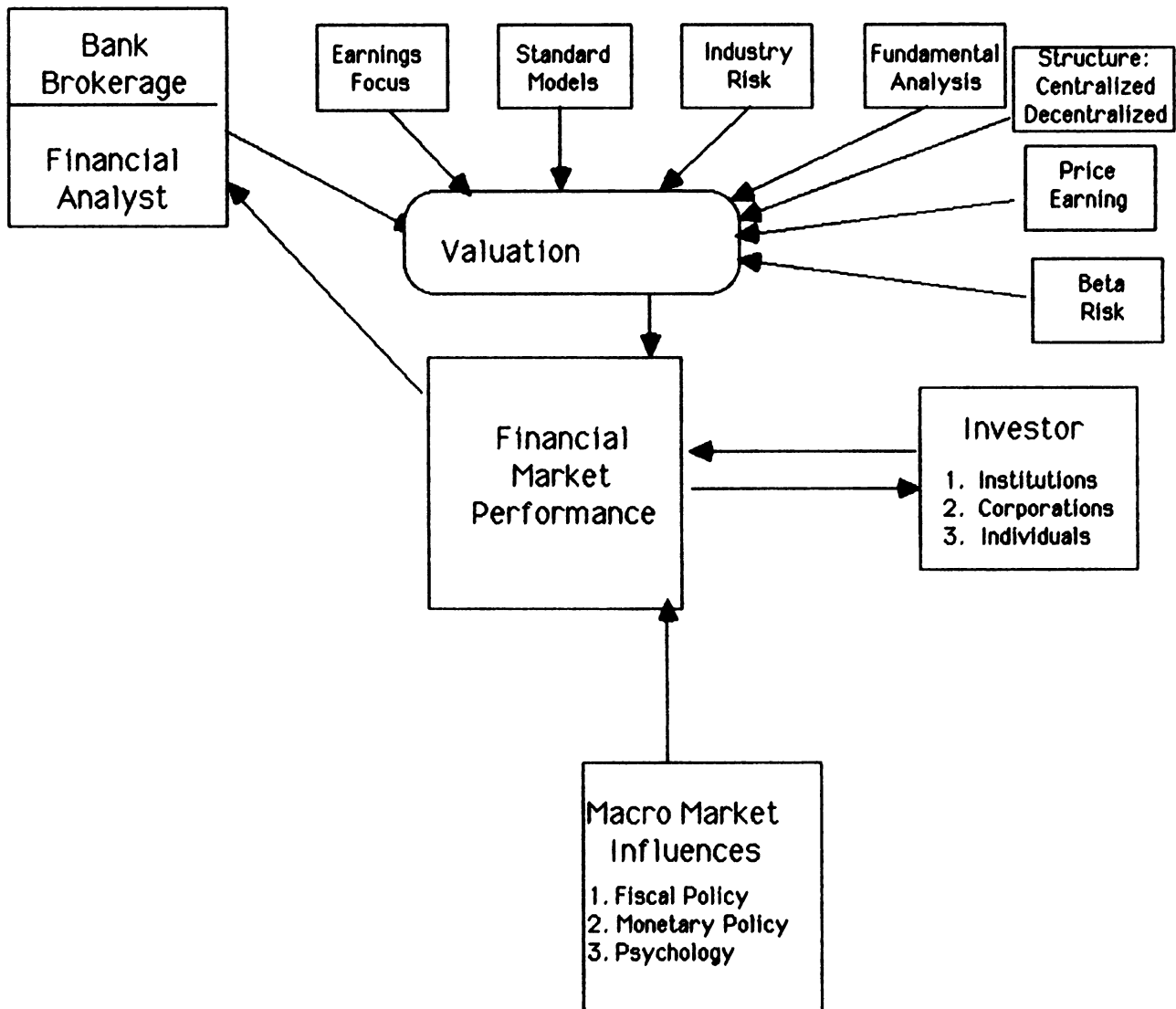


Figure 21

Financial Market Risk

-Corporate Filter on the Results of Product Market Performance

In the examination of influences in financial market performance, it was pointed out that one major input was published corporate earnings. One analyst pointedly commented that many analysts stop their research there (P1). If analysts wish to pursue information directly from the product markets, it must be recognized that corporate financial performance acts as its own filter for all product market information. One problem is the sheer complexity of today's large corporations. Many are multinational companies composed of large numbers of Strategic Business Units (SBU). In contrast, most product market discussions are focused on the product market of a SBU or a group of SBU's.

The original premise, that product market information would flow directly into financial markets, appears to be incorrect as a result of this exploratory study. In large corporations the product market performance of any particular SBU may appear insignificant in the corporation's financial figures. The importance of an SBU would depend on its size in relation to the corporation.

The potential for continuous changes in ownership of shares of publicly held corporations has a tendency to cause management to interpret the maximization of shareholder wealth to mean the the short term as opposed to some longer term horizon. It places an emphasis on information which may cause short term variance in financial market performance.

There are several factors that impact directly on corporate results which are not part of its performance in the product markets. These serve to modify the product market results. The first of these is capital structure. Capital structure refers to the debt and equity makeup of the organization. Some organizations have almost no debt while others

appear to be overburdened with debt. The cost of this debt load will dramatically impact the amount of earnings that are passed through from product markets to the published earnings of the corporation. Additionally, in many cases debt is used to acquire other firms which may bring with them depreciable tangible assets, plant and equipment and so forth, and depreciable intangible assets in the form of goodwill. An example of this was provided by the analysts in the newspaper industry in the form of the Capital Cities Communications acquisition of American Broadcasting Corporation (H2; F1). Basically, the acquisition required taking on a significant amount of debt at a time when interest rates were high and, because the amount paid was substantially above book value, a large amount of goodwill had to be entered on to the books of the surviving company, Capital Cities. The combined impact of the deduction for interest expense and the expense of amortizing the goodwill will reduce the earnings of Capital Cities.

Another corporate factor that impacts the results of product markets as they pass through the corporation is the financial riskiness of the corporation itself. The financial risk could be generated from any number of items. One of these factors could be the debt structure as was cited above. Some firms have not been able to structure their debt in a way in which it can be paid off in a timely fashion. In others, the interest charges are so high in relation to product earnings that the threat of interest rate rise is a substantial risk item.

Financial risk also occurs for other reasons including liability issues. A firm may need to set aside a substantial amount of funds for the eventual result of a liability suit (Johns Mansville, A.H. Robbins). The way the firm chooses to reflect the liability (for example, full or partial

write-off) will impact the way that analysts value the firm's stock. Financial risk may occur for a number of reasons and impacts the way that earnings are interpreted to the market, or by the market. Such factors, particularly those that impact earnings, help to filter product market performance. In some cases these factors may be of more concern to the financial markets than variation in product market risk because the danger is explicit and the impact is rapid and substantial. The financial theory helps understand the risk involved. A theoretical and effective measure to support the theory of product market risk is not available.

Another factor that serves to modify product market results as they pass through the corporation is the requirement that all companies report according to Generally Accepted Accounting Principles (GAAP). These conventions determine the way in which firms may compute income, expenses, depreciation, amortization, and so forth. In general, GAAP does not allow the amortization of marketing investments. One analyst discussed the development of USA Today by Gannett as an example of the impact of GAAP (H2). Gannett invested a substantial amount of capital creating a product market for its newspaper. Even though Gannett may have achieved some substantial market strength nothing is flowing to the bottom line because all of its marketing investment is expensed. If, on the other hand, Gannett had spent the same amount or more to acquire a newspaper it would have been able to amortize that acquisition over a number of years and show the amount that remained to be amortized as an asset. This would have greatly increased reported income and assets. This is just one example of how differing accounting treatments affect product market results as they pass through the corporate filter.

Tax laws also impact how a business processes the inputs that it

receives from the product markets and its cash flows. In short, if the market is earnings driven and tax laws as well as GAAP do not allow the amortization of long-term marketing investments then there is much less of an incentive for management to invest in product market development than there might otherwise be (Fruhan). Tax laws have significant impact on both the macro and the corporate level.

The quality of management also impacts the way results are filtered. In this case, the concentration is on strategic management. Several of the analysts discussed the idea of looking at what the Chief Executive Officer is doing with the organization. A bank analyst spends quite a bit of time speculating on what he would do if he were in charge of the organization (G2). Many of the analysts suggested that, when firms get larger, the management may not make as much difference but that it is more important in the small and medium size companies (J1).

Technology is also important to the modification of corporate results. It is one of the factors, along with management, that analysts looked at as part of their subjective evaluation of the firm. Analysts were concerned with whether the company was staying current with technology and would be likely to be competing with the next generation of products. One of the major concerns is how will the firm survive in a period of seemingly shortened life cycles, (K1). Analysts focus on whether a company would have the technology to develop the product but rarely seemed to consider whether the company has the ability to develop the market in a way that gains early and substantial product market acceptance.

Product market investment is another factor that impacts the corporate results. What is the firm spending on market investment? Are they developing markets or only harvesting from them? The Gannett/USA

Today example stands as an example of a firm willing to make a large investment in the product markets. This is certainly impacting the short-term results of Gannett's operations in terms of what gets passed through in the form of earnings to the corporate reports.

Industry structure also can have a sizeable influence on the level of corporate performance. Changing industry structures may have a profound impact on earnings. An analyst in the computer area based much of the evaluation of firms on the changing industry structure. In this case, the developing overcapacity and the shrinking size of the market potential substantially increased product market risk and necessitated a reconsideration of the valuation of any firm involved in the industry. The analyst pointed out that the further back in the channel a company is, the more affected that firm might be as the industry changed (L1). This is recognition of product market risk.

Another example of the impact of industry structure could be found in the reorganization of all the health care providers that have been required since the government and insurance companies forced the issue of cost effective care. Previously, the objective was not cost, but rather providing the patient care at any cost. The change to cost effective care has forced a major restructuring through out the entire industry (N1).

Industry structure could be changing in a number of different ways. Traditionally, academics have examined both vertical and horizontal composition of industry structure. Depending on the firm, one or both of these could be important. Of equal importance are what kinds of barriers to entry exist. In some industries, the barriers are in the form of technology, although, with the exception of the drug industry, analysts stated that technology is so readily available that this does not seem to be

the barrier it once was (K1). Barriers may also come in the form of cost of entry, or the inability of the market to support a competitor.

Newspapers in many towns are such a case. Most towns, and even large cities, have found that they can not support more than one newspaper.

USA Today has proven to be weak competition at best, since a national paper can not provide all the local stories that are wanted by the local readers. Thus, there is a real barrier to entry in this market.

Two other ways of characterizing industry structure are turbulent and placid." One might describe the high technology industries as "turbulent because they are constantly in a period of rapid change. Relatively few deciders make or break this industry. On the other hand, the drug industry might be described as more placid since it is possible to see far ahead because of the long term approval process required by the Food and Drug Administration (FDA) and, has the advantage of the seventeen year life of the patent once it is granted and approved for intended use. It is very difficult to unseat the pioneer of a product in the drug industry as the new entrant has to prove that it is better and more cost effective before doctors are likely to start prescribing the medicine. Thus, the drug industry has less to expect in the way of abrupt change in their product markets and therefore can plan on a longer term basis the needs of plant and equipment. Another factor that may lead to the more placid state in the drug company industry is the long lead time it takes to develop a product. It often takes years of research before a product is ready for an application to the F.D.A. and, except for the cosmetic or fad items, years of market investment to develop product presence. A regulated industry generally provides a placid environment, for example, cable television, utilities, and until recently, transportation.

Another factor that impacts corporate results is currency risk. Many companies today are multinational or involved in foreign trading. Like interest rates and debt structure, its currency risk can have a direct impact on what is eventually passed through as earnings.

In summary, there are many factors that impact corporate performance in addition to what is coming in from product markets. These factors serve to modify the results that lead to the published earnings of the corporation. One of the analysts spoke about the options that management had in terms of adjusting performance. Some companies may have shrinking sales but, by careful management and cost cutting procedures, these companies can be successful at increasing profits in each quarter for quite some time, (G1). It is also important to remember that there are usually a number of SBU's and the allotment of resources between them may change overall corporate performance. For example, if one unit is in the middle of a product launch, it may be consuming a substantial amount of resources while other units are producing income. This to would affect what is passed through in the form of corporate earnings (Figure 22 shows the factors that impact corporate performance).

-SBU Filter on Product Market Performance

The strategic business unit itself acts as a filter on product market performance. There are a number of factors that impact the performance of the SBU, including those that one is normally concerned with in marketing such as performance measures based on historical sales.

One of the other factors that impacts the performance of the SBU may be the industry structure as discussed above in relation to the corporation. It is not uncommon to have corporations that are so diversified that the

Another factor that is not an external factor is the company's financial position. A company's financial position is a measure of its ability to pay its debts and other obligations. It is a measure of the company's liquidity and solvency. A company's financial position is a measure of its ability to pay its debts and other obligations. It is a measure of the company's liquidity and solvency. A company's financial position is a measure of its ability to pay its debts and other obligations. It is a measure of the company's liquidity and solvency.

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It is not uncommon to have corporations that are so diversified that they do not have a dominant industry structure as discussed above in relation to the competitive advantage. For example, the diversified corporation that has a number of divisions that are in different industries, such as the diversified corporation that has divisions in the food, clothing, and electronics industries, may not have a dominant industry structure as discussed above in relation to the competitive advantage. One of the other factors that impact the performance of the diversified corporation is the marketing such as performance and brand based on the diversified corporation of the SBU, including those that are normally associated with the performance. There are a number of factors that impact the performance of the diversified corporation that are related to the competitive advantage. The strategic business unit (SBU) that is a diversified corporation may have a competitive advantage.

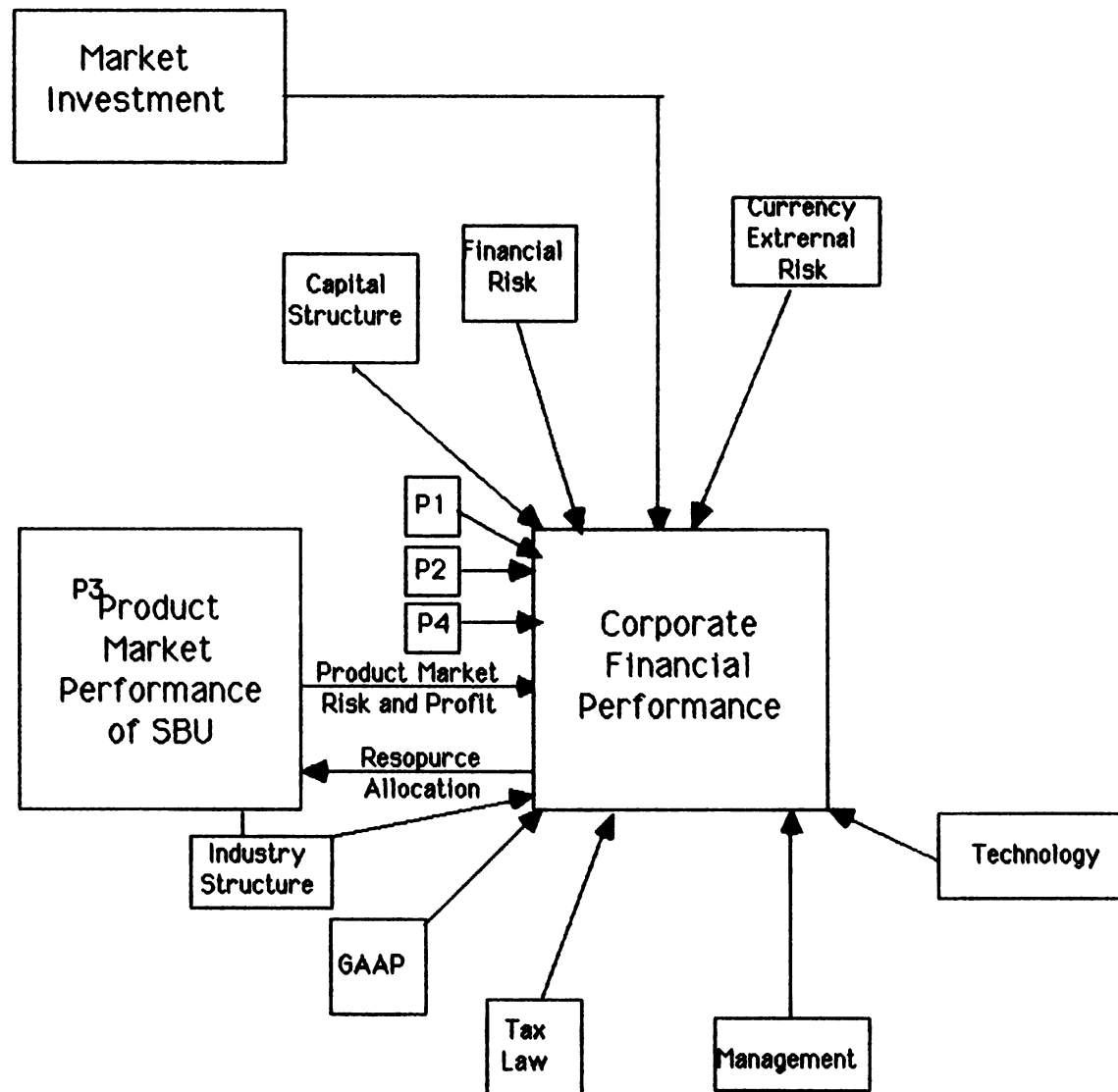
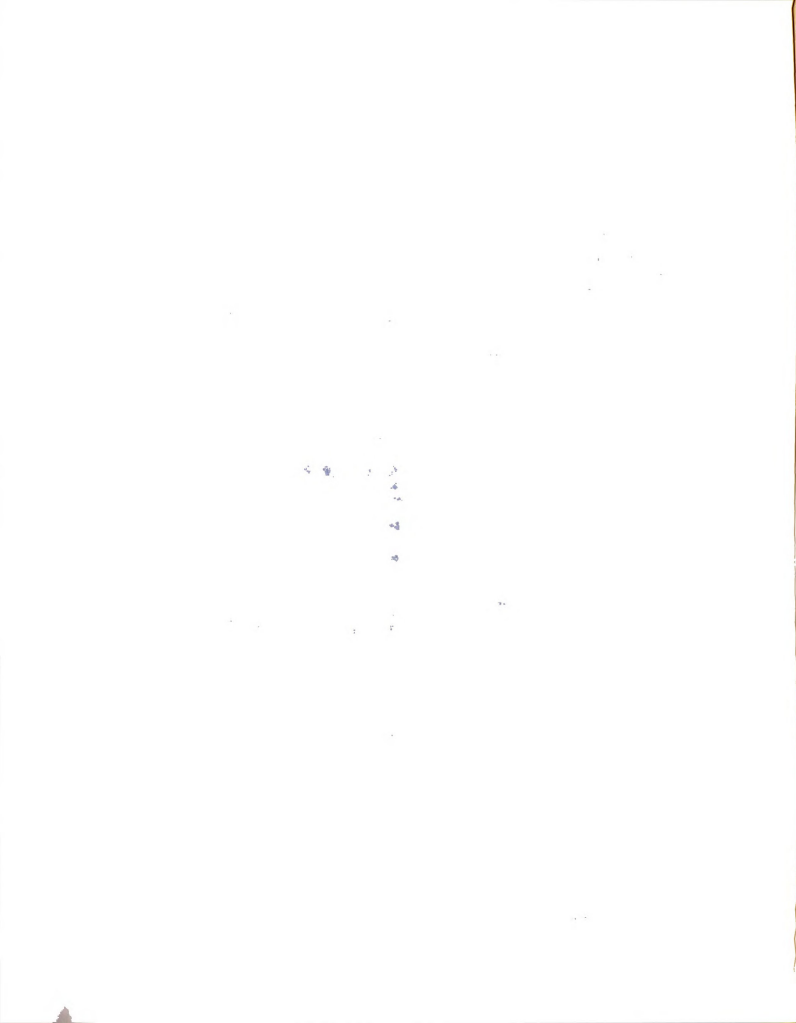


Figure 22

FACTORS THAT IMPACT CORPORATE PERFORMANCE



different business units belong in different industries. The characteristics of the industries are important to understanding the success of an SBU.

One of the most common performance measures to look at in terms of the SBU is market share. Market share is dependent on at least two primary factors: one is definition of the market and the second is competitor sales. The definition of the market can always change the market share measure. The broader the definition of the market share, the smaller the share; the narrower the definition, the larger the share. The definition of the market will also impact the growth rate for the product class or form. Because of its impact on these two factors it will also impact such things as the Boston Consulting Group (BCG) matrix. These two traditional sales-derived measures, market share and the BCG matrix, have been and are extremely useful tools in understanding the success of the small business unit in the product market in an historical sense. It is hard for these historical measures to carry any information for the future. Trends and extrapolation of past sales can be developed but they do not indicate changing consumer preferences.

Production is another factor that interfaces with the successes of the SBU. In most cases, production is a separate unit from the marketing units (Hayes and Wainright, Restoring Our Competitive Edge). In terms of success for the marketing units there is an interface with production in the areas of quality and cost. Quality is essential to meeting the customers' expectations and, therefore helping the unit to maximize its potential. If the manager of an SBU is attempting to maintain increasing sales and needs to bring a new product out, they are dependent on the input of production to deliver that product at a time, price, and quality



that will fit with the rest of the schedule.

Often, in marketing, this interface with production is overlooked. The interface should be in the design stage. Marketing should specify: (1) appearance, weight, size and so forth, (2) quality, and (3) cost. Production can be a key input to the product market success of an SBU. One of the ways, in addition to timely delivery of the product, that production can have a big influence is in the product that is delivered. A product on the market that is not living up to quality expectations can severely hurt a unit not only in the present but in the future. This is even more serious if the unit is seeking to become the standard in its industry. A quality problem may have a substantial impact on product market risk. Recently a number of United States companies have learned the lesson of letting quality in production slip as American costumers have turned to foreign manufacturers for purchases and for their standards of performance and quality.

The other point that requires emphasis in the interface between production and the strategic business unit is the cost factor. What cost are going to be charged coming out of production into the unit. These cost have to allow for a price to customers that falls within their set of standards for the quality and performance offered and at the same time provide a margin sufficient to cover SBU and corporate level costs and provide a sufficient profit.

Government regulation is another factor that impacts the SBU and its performance. There are many constraints on selling practices, taxes and other factors that impact the SBU and serve as filter of its results. For example, as has been discussed in the drug industry, regulation in the form of the FDA plays a big role on what is done. In fact, one of the analysts

[illegible]

the 1990s, the number of people who have been convicted of crimes has increased significantly. This is due to a number of factors, including the fact that the justice system has become more efficient in processing cases, and the fact that there have been more crimes committed in general. However, it is important to note that the increase in convictions does not necessarily mean that the justice system is more effective in punishing criminals. In fact, many studies have shown that the justice system is often inefficient and costly, and that it does not always lead to the best outcomes for society. Therefore, it is important to continue to evaluate the justice system and to make improvements where necessary.

mentioned this as one of the major risks in the drug industry (K1). Another example would be the government regulation of many industries including public utilities, transportation, banking, and so forth. Factors that impact the product market performance of the SBU can be seen in Figure 23.

-Customer Behavior

In looking at the product market, Figure 24, one sees it is divided into major sections. One is the customer behavioral component and the other is the customer cognitive and affective component. The behavioral component is the one that most of our marketing performance measures focus on. Almost everything that is looked at for performance is sales based.

A few of the analysts did attempt to understand as much as they could about the product market customers and product market risk. Two specific examples are important. Both of them are in the computer area. One analyst went directly to customers and asked them what their purchasing commitments looked like for the next period. This was a direct survey of customer spending. In industrial purchasing it takes longer to make a decision and put it into action than it usually does on the consumer level. Therefore, it is possible to understand the market for a short period of time by talking with these customers that have basically made the decision but have not actually made the purchase. The second example is quite innovative: the analyst studies expected sales by surveying professional sales people in the industry. Over the years, the analyst has developed a cadre of about one hundred sales people that are queried at regular intervals to see how they feel about the market for their products,

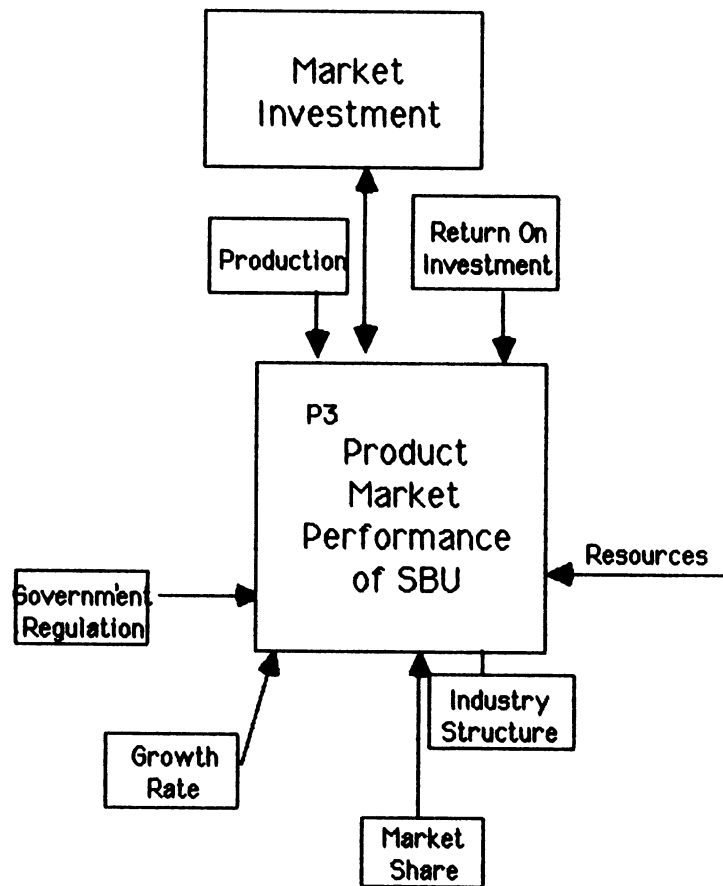


Figure 23

FACTORS THAT IMPACT SBU PERFORMANCE



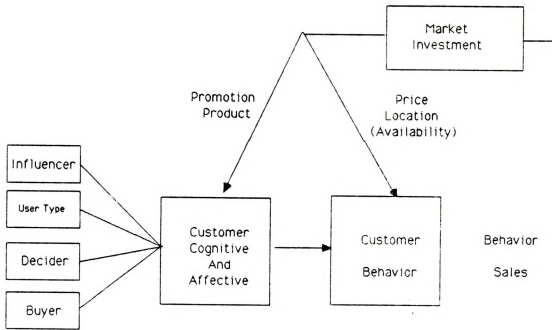


Figure 24

CUSTOMERS IN THE PRODUCT MARKET



their competitor's products, the general tone of the economy, and the industry. This has provided the analyst with advance notice of the trends that are developing. Both of these are good examples of looking at the customers in the product market and how changing conditions may impact customers. It is an attempt to try to understand what may be happening by looking at expected behavior in the product market .

There is a second level or, more appropriately, the precursor to behavior. This is the cognitive and affective state of the customer (see Figure 25). No analyst was doing direct research into this area and yet these things do trigger behavior. It would be important to consider these for all the possible participants in the purchase. The participants that would be most important to consider for any given product will vary depending on the product classification. For example, in the prescription drug industry, the following labels might be applied:

- | | |
|---------------|------------|
| 1. Influencer | Pharmacist |
| 2. Decider | Doctor |
| 3. User | Patient |
| 4. Buyer | Insurance |

In other industries, the users and buyers might be more closely related. It is not important whether this is the correct classification but what is important is that an analyst should spend time looking at what the decider thinks of the product. This is exactly what was found at a drug boutique where the analyst specializing in medical products revealed that they used a continuous delphi group to comment on what doctors and the medical community were thinking about products of the companies that they were following (N1).

The same analyst gave an example of how important the buyer can be.

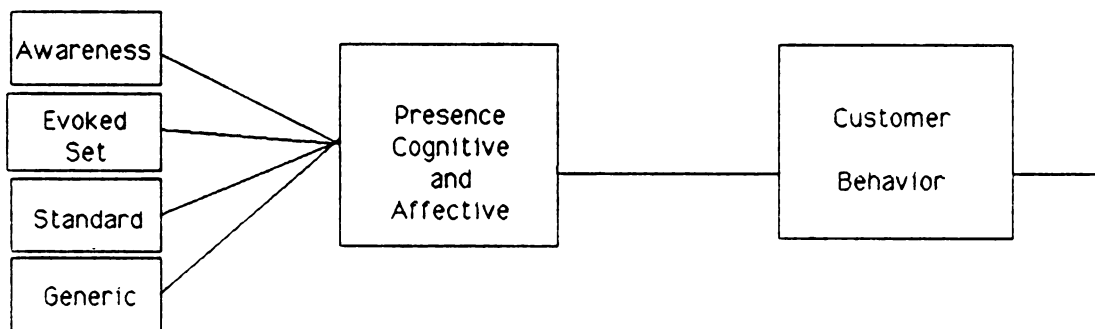


Figure 25

ELEMENTS LEADING TO BEHAVIORIAL ACTION



The case of the change in the medical industry from what was most effective at any cost to what was most cost effective was really brought about by the buyers, the government, and then the insurance companies. An understanding of how the buyers were looking at the product market offerings would have helped an analyst to expect the kind of restructuring that has been necessary in that industry because of the changes in the buyers (N1).

Another important thing to be considered for many types of product market situations would be to look at the user types that are involved. One might expect to get different information from different user types: (1) previous user, (2) current user, and (3) never used. In the case of many products, research might indicate very different feelings among these user classifications.

For a complete look at product market filters, in the form of both customer behavior and the customer from the cognitive and affective standpoint (see Figure 26).

-Financial Analysts Have an Unclear View of Product Markets

If all the parts are put together, as in Figure 27, it is clear that there are many filters between the financial markets and the customers, which tend to obscure product market risk and return of a specific product. It is not difficult, from this perspective, to understand why the analysts do not focus on the elements that have been attributed to presence. Analysts have no models or measures for analyzing the cognitive and affective areas.

Some analysts were found to be considering some product market information in evaluations. One of the examples was found in the

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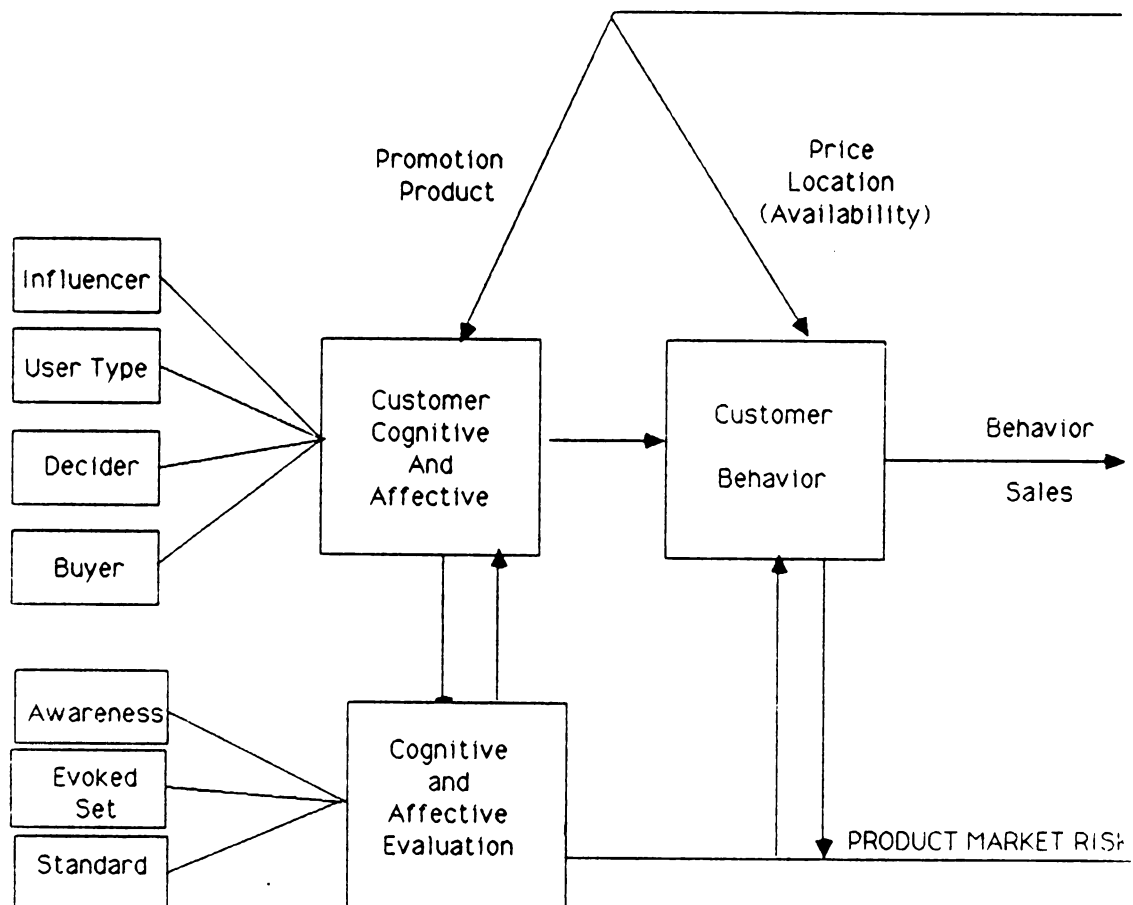
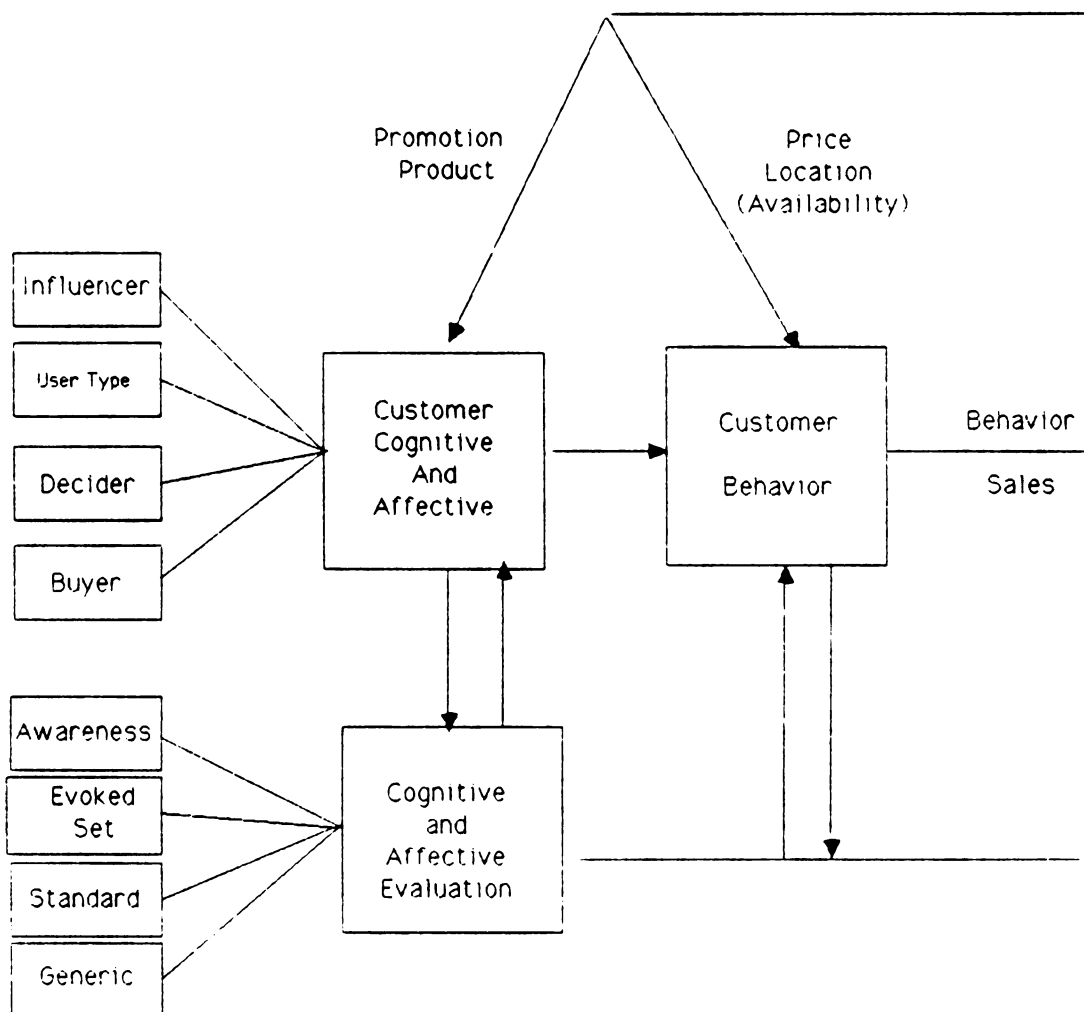


Figure 26
PRODUCT MARKET FILTERS



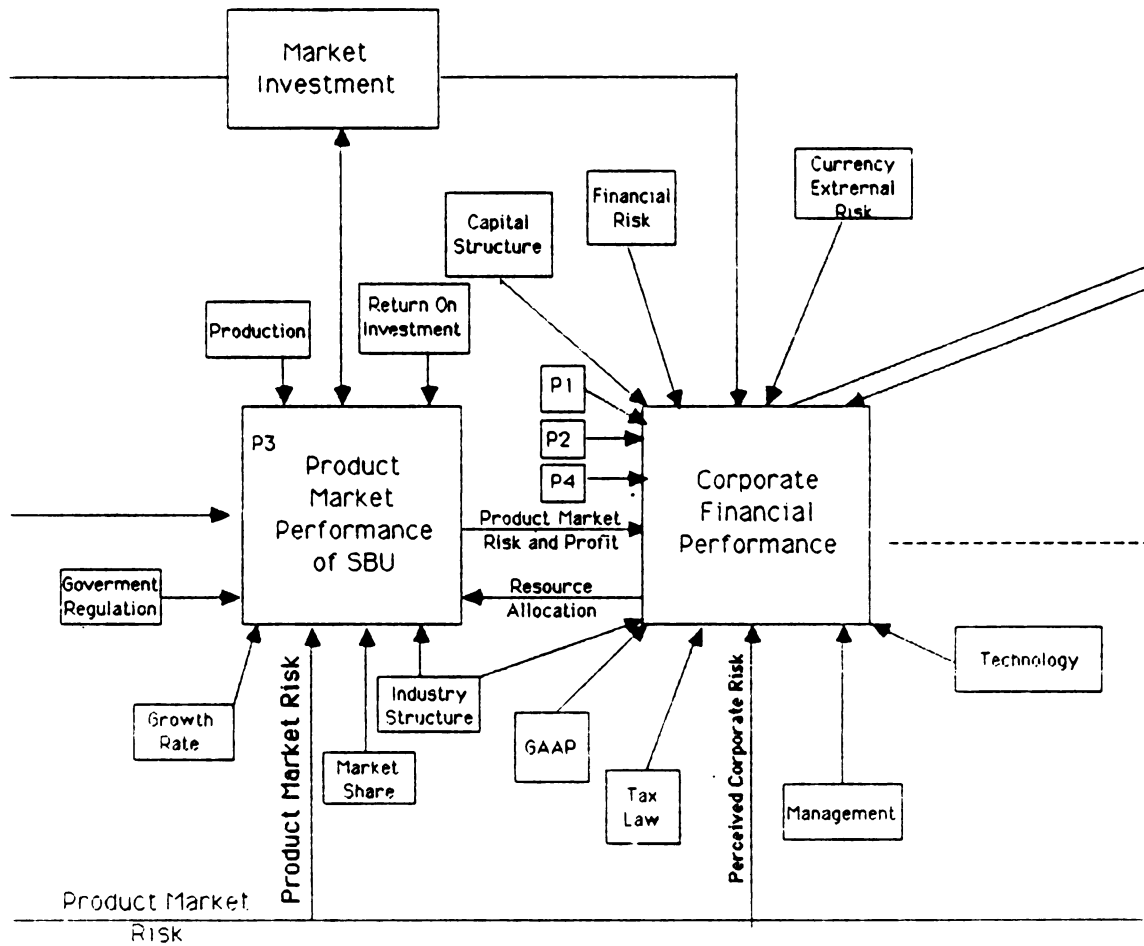


ProductMarket Risk

Figure 27

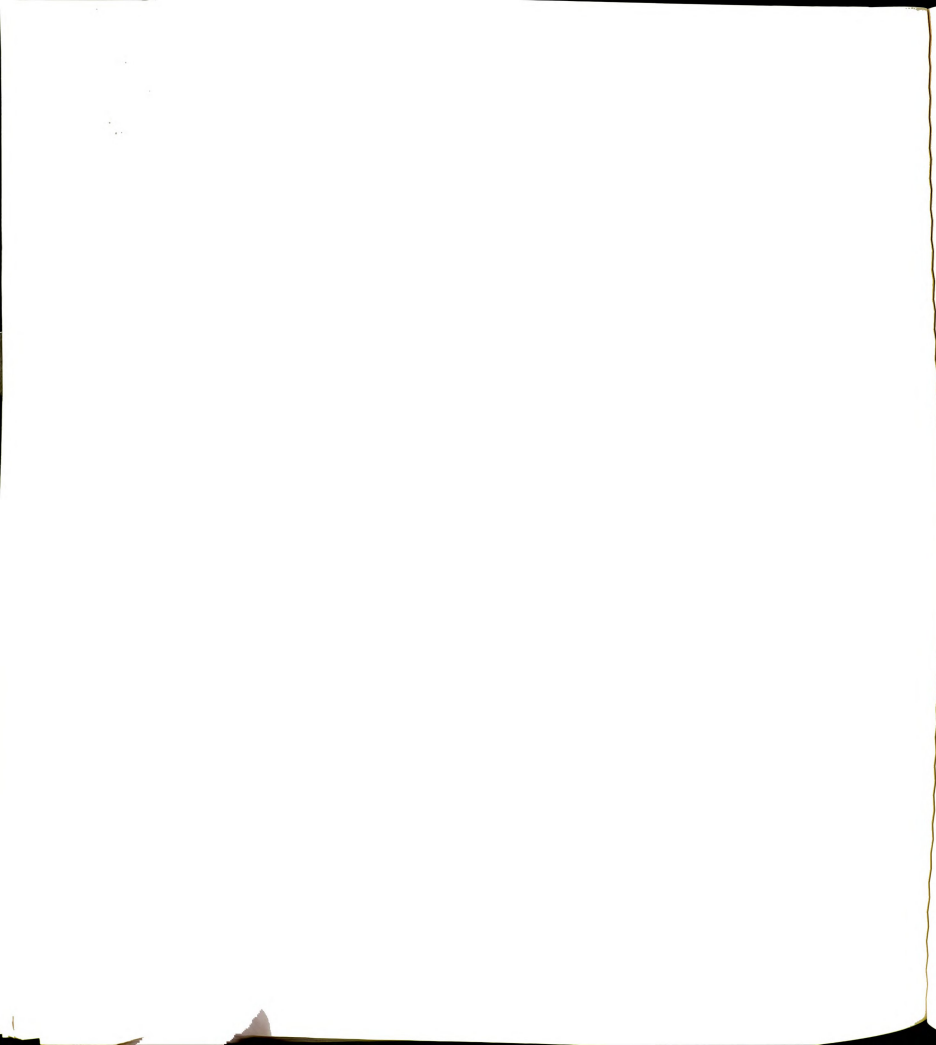


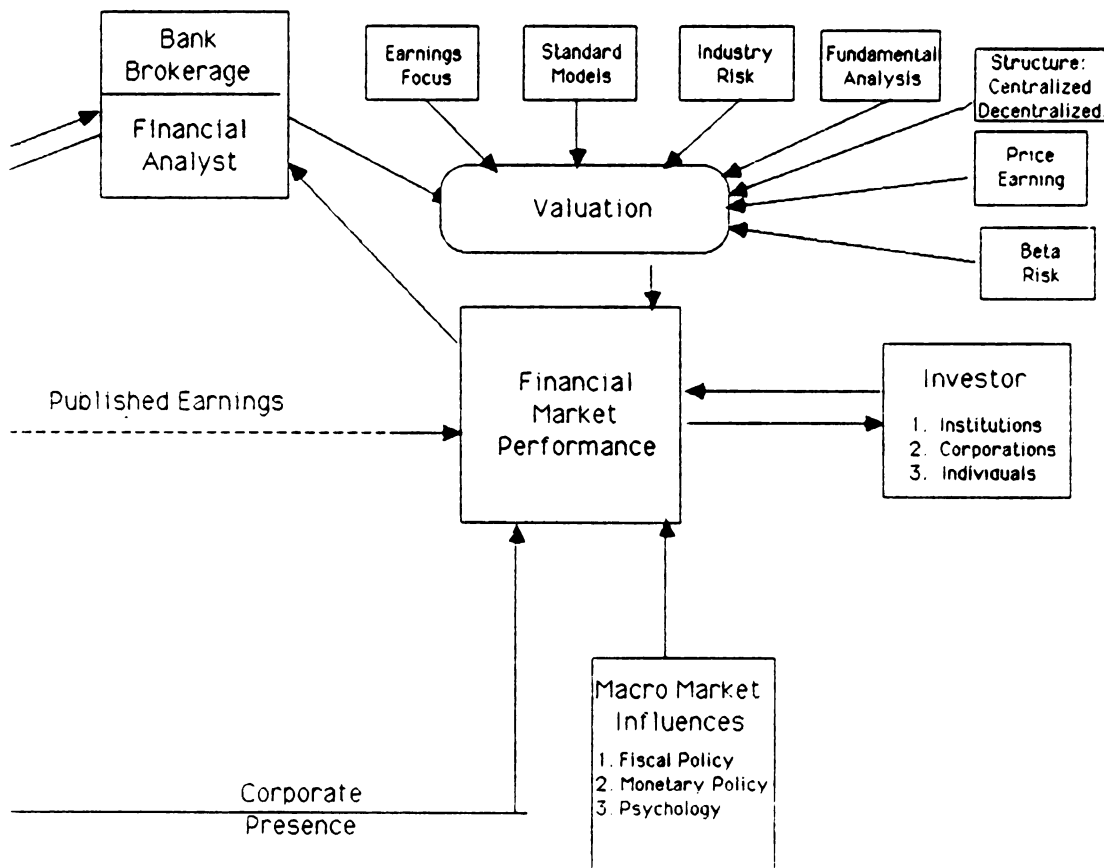
Relationship of PMP and FMP



Company Specific Risk

Figure 27 cont'd





Financial Market Risk

Figure 27 cont'd



newspaper industry, where one analyst attempted to forecast possible advertising sales by looking at the industries that buy most of the advertising from the newspapers and then attempting to forecast what kind of advertising expenditures they will make in the future, therefore impacting the advertising revenues the papers may receive (F1). This is a method of going through the whole system and attempting to look at the factors that might influence behavior.

Other areas include the previously mentioned medical delphi group; survey of computers sales people; and, the Gartner Group looking at the product, the producer company, the industry, and the customers in all classifications.

Looking at the product market through the filters tends to be done when it is easy to do. One of the analysts in the drug area made a strong case that one of the reasons that minoxidil (Regain) has had such an impact on The Upjohn Company is that the product is perceived to be easily understood by analysts and therefore they felt comfortable in taking the expected product market performance into account. They also felt comfortable making some risk estimates for the product. This is not to belittle the many other factors that have been influencing the stock of The Upjohn Company recently but to point out that, in many cases, analysts do not feel that they can make any kind of reliable product market performance estimates because they may not understand the market fully or there may be too many products for any one product to have a significant impact.

--Tiers of Influence

One way of viewing the model is that there are so many tiers of influence in financial market performance that it makes it difficult for analysts to define and project the importance of the product market performance. The tiers are: (1) financial markets, (2) corporate financial performance, (3) SBU's product market performance, (4) customer behavior, and (5) customer cognitive and affective (see Figure 28).

Therefore, it is understandable that few commented directly on the elements of presence as being important in their valuation decisions. Where the analysts do focus on the product markets there is a clear focus on the behavioral dimension. This is not surprising since there is a real focus on earnings and the short term.

In most cases, the analysts, because of the nature of their work load, were forced to concentrate on the first tier of influence. From their perspective this would be the financial market risk and it would tend to have the most immediate impact on all securities. Financial market risks are major factors that impact the immediate actions of securities markets. One can look at any of the formulas that analysts are working with and see quickly what a major change in interest rates would do. Additionally, there are many changes that are not as global as an interest rate change that have a major impact on all members in the financial markets and therefore have to be of constant concern to analysts. Given this short term focus there was still evidence of looking at presence on the corporate level. An analyst spoke of a company with falling sales in the existing product line but whose stock value stayed up because it was believed that the company had the potential to introduce new products successfully to this market (G1). This is a recognition of presence on the

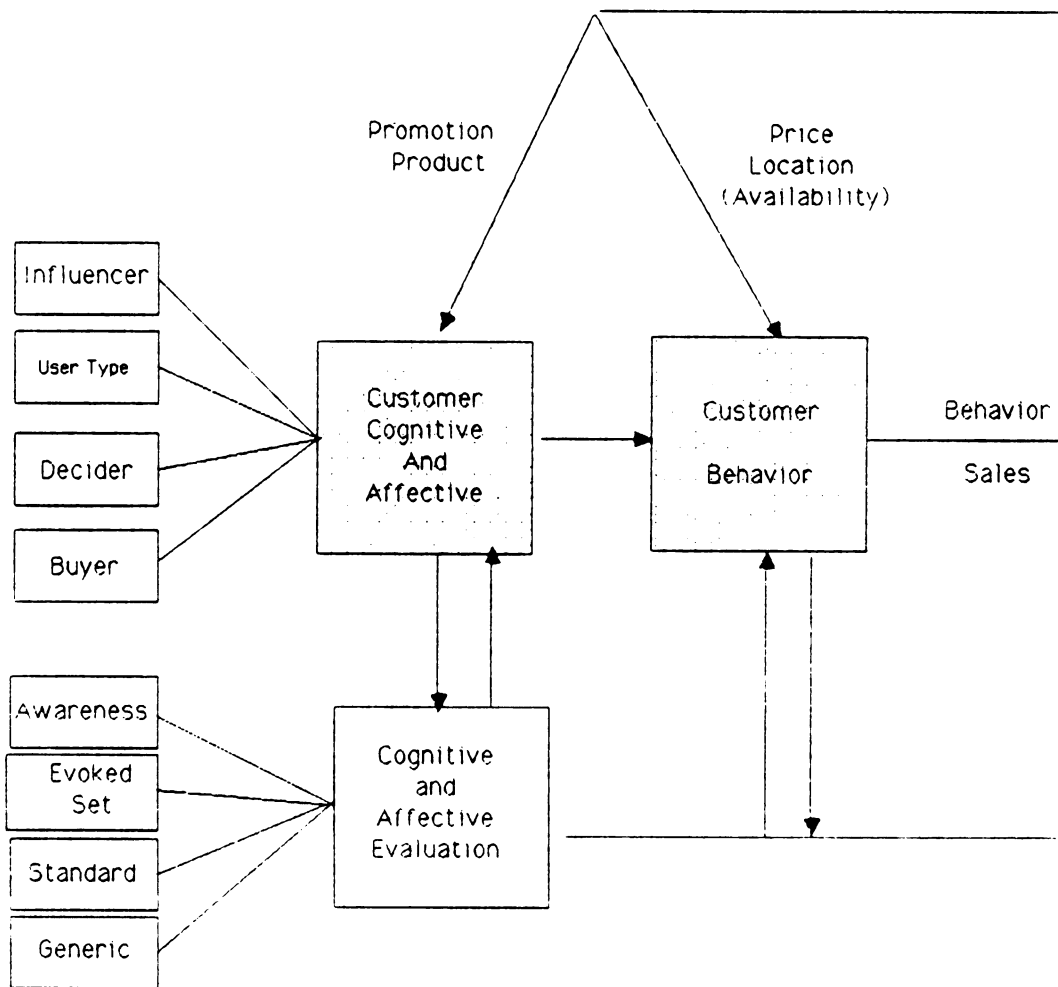
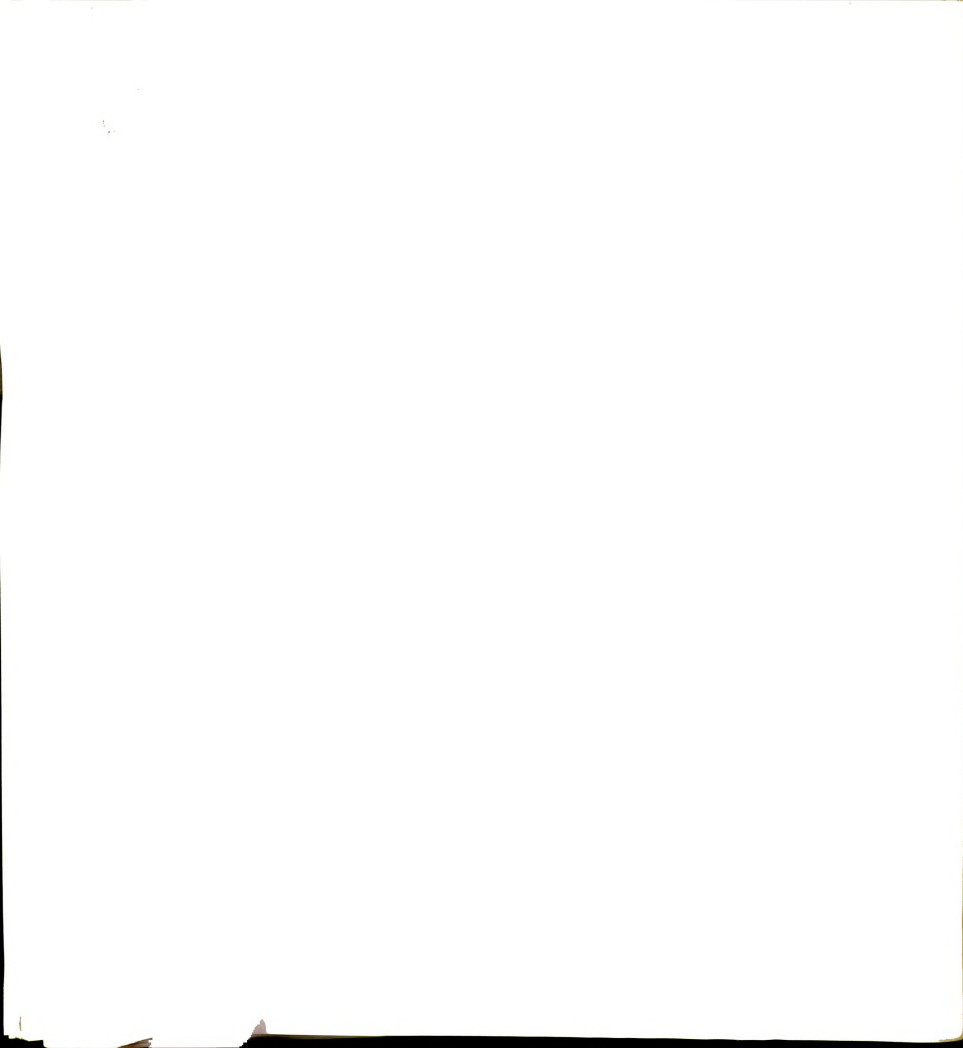
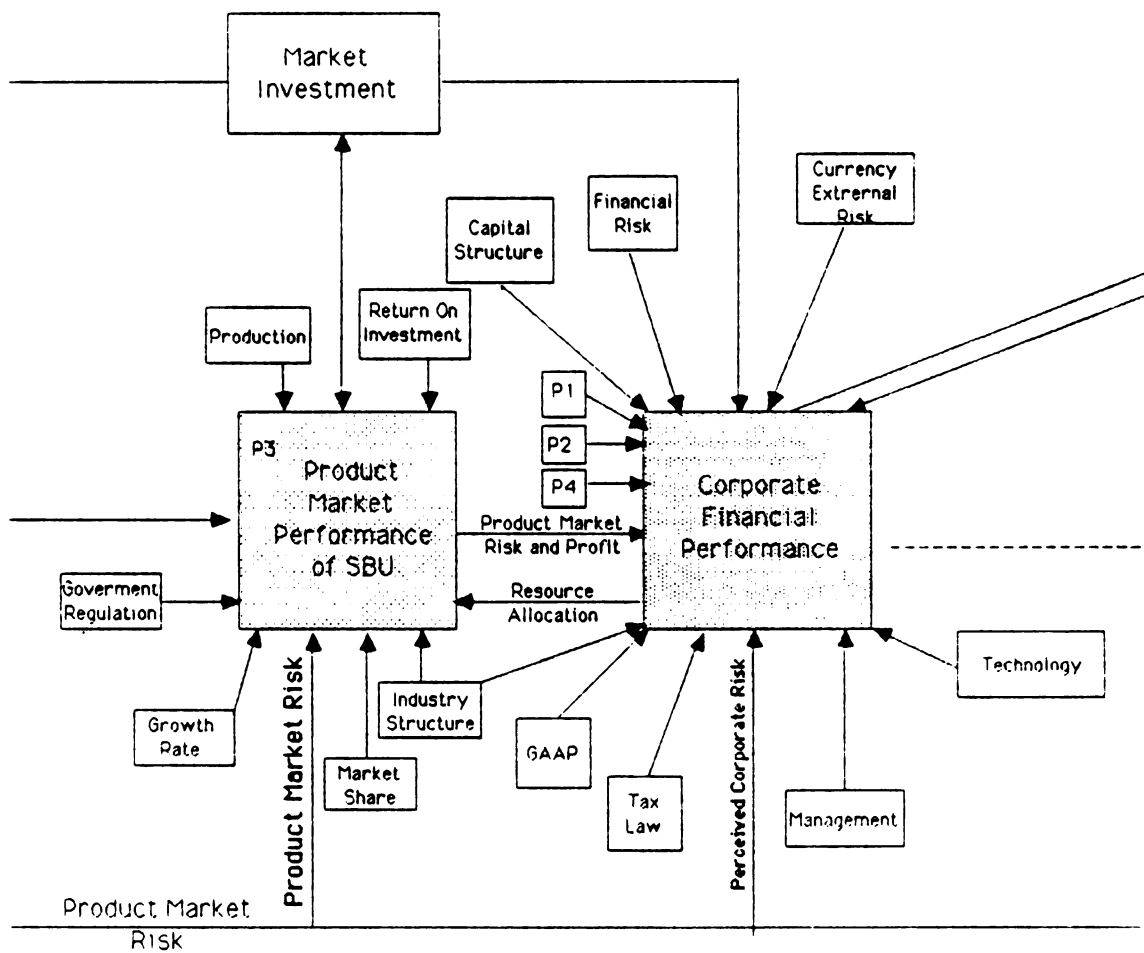


Figure 28

ProductMarket Risk

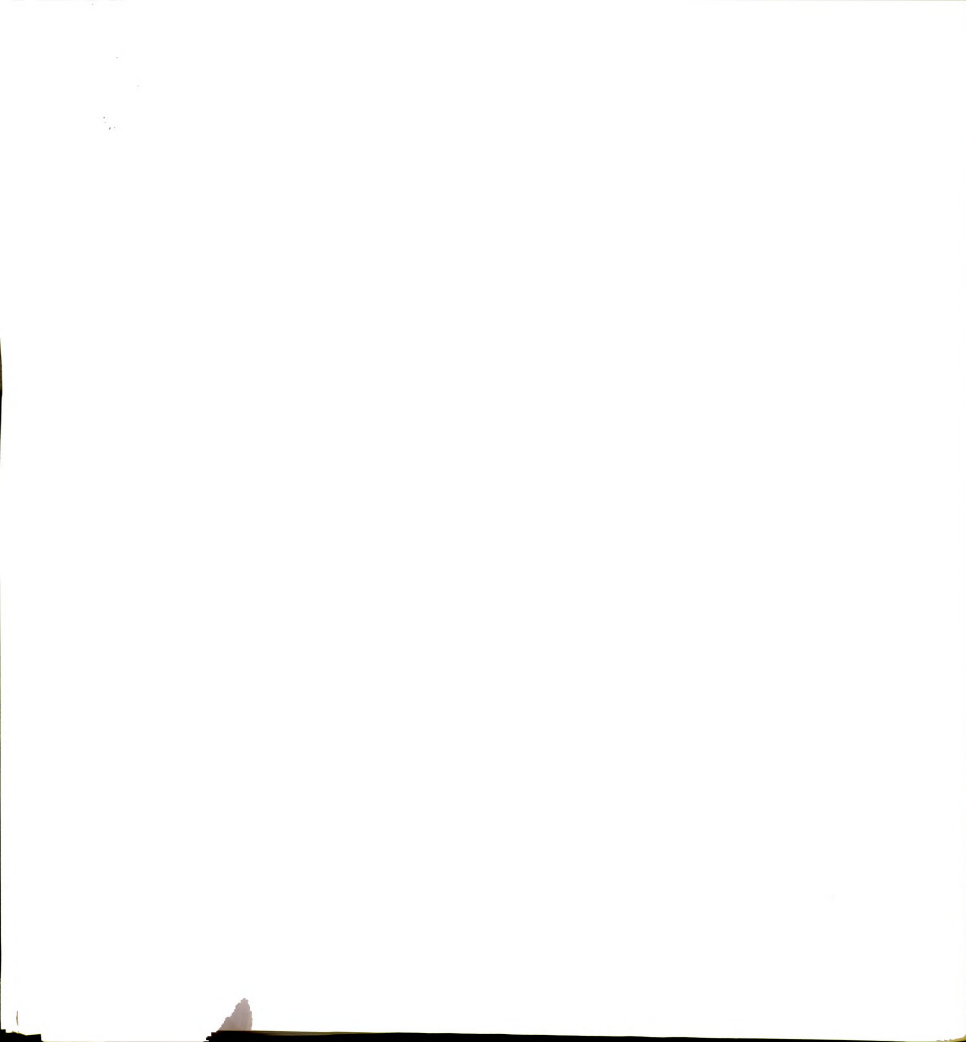


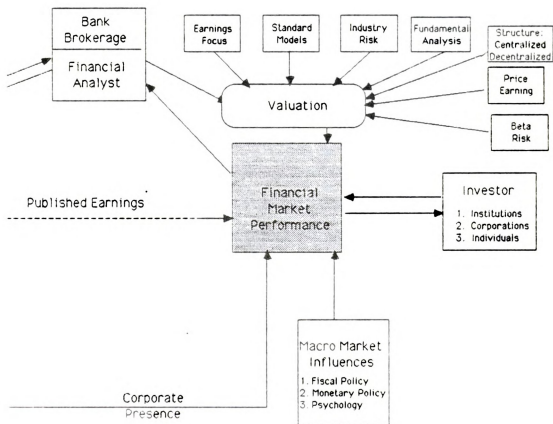
Tiers of Influence



Company Specific Risk

Figure 28 cont'd





Financial Market Risk

Figure 28 cont'd



corporate level.

Analysts also looked at factors that had to do with company specific risk in almost every case. Many were basically looking at published earnings with an implied assumption of continued corporate performance along the same lines. This may be one reason why a downturn in earnings often produces a shock in the financial markets if it is not recognized in advance. Some of the sellside analysts attempt to understand more of the company specific risk tier as has been discussed above. Presence could influence this level as it would allow companies to make better decisions on allocation of resources if they had a measure of risk in the product market.

Few analysts actually looked at SBU's or product market area. This may be a function of the lack of available data. Those who did look at SBU's or the product market seemed to concentrate on the behavioral aspect. There was almost no one looking at the product market risk area as an indicator of the future. The entire orientation was either toward the historical or an attempt to estimate the very immediate future by intuitive adjustment. This does not necessarily pick up developing trends that might be seen by looking at the customers' cognitive and affective position. It is as if business believed in manifest destiny; once the course is set in action, it will continue along the same path.

The tiers of influence make it difficult for the financial analyst to relate to the product from which income is generated. When analysts do attempt to understand what is happening they have no real measures to use to determine product market risk even in a relative sense. A company could be continuing to make sales because of a low relative price but be weakening its standing among customers to the point where it would be

[illegible]

much less of a competitor should price parity develop.

Depending on the company, presence can appear by product, by product line, by brand, by S.B.U., and at the corporate level. It is important to understand that presence may be useful to both the marketing and the financial professions, particularly those who attempt to estimate the investment value of stocks.

Presence is important as a cognitive and affective concept. Behavioral measures are historical performance measures. They contain only information about what the buyer has done, and possibly what the pattern of purchase is like, but they do not contain future information such as changes in standards or reactions to changing environments.

Risk is future oriented by definition. There is no risk in things that are known. It is only the future that contains elements of risk. It is important there be a measure for product market risk, if risk and return are the basis for valuing companies, and the goal of the company is maximizing shareholder wealth.

Presence, as conceived, is an indicator of an intangible asset for the future. It provides a way of estimating risk. The cognitive level refers to information on how well the product is known and may well be a measure of awareness and possibly generic use of the name. The affective level is more related to the acceptance of the product as a standard and placing it in the evoked sets.

Product market risk appears to be included in business risk in financial theory (Chapter Three). This would be somewhat equivalent to combining the concepts of product market risk and company specific risk. When product market risk is added into operating risk, it is overshadowed by the elements in the tiers closest to the financial markets--those things that

are impacting directly on corporate performance. It is time to try and understand with more clarity what the product market risks are and how product market performance passes through to the firms' shareholders. It is only in this way that marketing management will be able to contribute better to the goals of the firm.

Conclusion

The evolution of the model has been laid out. It was developed to aid the understanding of the relationship of product market risk and the concept of presence with the performance of the company in the financial markets. The model's development has clearly been impacted by the research choices, hopefully; further research as, suggested in the end of chapter seven, will lead to refinements that will make the model more generalizable. If the model serves as starting point in a discussion of product market risk it will have made its contribution. With the model as a framework, it is hoped that presence can be measured. Such a measure could be extremely useful in strategy, evaluation of management, and in financial evaluations.

The model contains arrows indicating direction of flows but it does not currently contain information about strength of flows or the nature of their impact. It is suspected that all weights should be the same but they may be read very differently under different scenarios depending on the perception of those using the model. More research is necessary to understand the weights as will be explained in chapter seven.

CHAPTER SEVEN

IMPLICATIONS

Introduction

The idea of product market risk and the concept of presence is explored as it might be applied in practice and in additional research. First the ideas presented in chapters one, two, three and six, are examined from the viewpoint of the financial analyst. Second, the same ideas are looked at in terms of application by marketing management. Third, the implications of the model and further suggestions for research in that area are developed. Finally the four research questions are addressed with suggestions for further inquiry.

Product Market Risk and the Financial Analyst

From the standpoint of the financial analyst, it is important to understand what impact the development of an indicator of product market risk might have. Analysts are continually looking for inefficiencies or market imperfections, such as new pieces of information not currently reflected into the market price. From the interviews, it is evident that there are several ways in which this risk information could be particularly useful.

Financial Markets Future Oriented

Financial markets are future oriented. Everything that is done in the financial markets has to do with risk and uncertainty. The analyst prospers in relation to his success in appraising the likelihood of future

events. If the future were certain there would be no speculation.

The analysts interviewed explained that there was a complete and total separation of the horizons for evaluation and the horizons for holding securities. Some analysts were using a fifteen year horizon for valuation but only holding the security for a few hours (E2). Other analysts talked about holding securities for a long time, but constantly reevaluating their portfolio on a very short term. It was made clear that they would not want to value a security based on estimates of earnings two or three years out.

-Focus on Stocks

Analysts also pointed out that they have a real focus on stock values and that stocks are in the financial markets. In contrast to the efficient market theory, they carefully tried to separate the idea of good and bad stocks from the idea of good and bad companies. Thus, there are good companies whose stocks are considered bad because they are believed to be overpriced, and bad companies whose stocks are believed to be good even though the company is currently very weak. This separation is a key to understanding the focus on the analyst and the evolution of the model with its separate components of financial market risk, company specific risk, and product market risk. One analyst, when asked about this issue of good and bad companies, explained that he considered a negative development at a good company an opportunity if it would drive the stock price down far enough to make the stock also a good stock. Another analyst spoke of looking for something that is not perceived by the market which might make a bad stock appear good. He focused on trying to find good stocks and not good companies, because it is hard to make money on

the sellside on good companies because you need good stocks (see Figure 29).

-Future Earnings Derived in Part from Product Markets

Many of the models that are used in the valuation of stocks are dependent on estimates of future earnings. These future earnings have to be derived from the product markets through the corporate filters. Many analysts assume some sort of growth rate for earnings. In the case of the dividend discount model, they estimate how long a firm might expect to have excessive earnings, which should lead to some excessive value. The assumption is that eventually, in three to seven years, all firms will have normal earnings. To develop future earnings estimates, most analysts are forced to use information that has come through corporate filters. There are three areas that could be looked at in the product markets to attempt to estimate future earnings; (1) current products, (2) announced, unreleased products, and (3) unannounced products.

Current products are the ones that are most often considered in estimating future earnings. These are the products that everyone is most familiar with and they have an available, historically based sales measure. There is a tendency to focus on market share as a performance measure. However, one of the analysts pointed out that he does not use market share because it is a historical measure and does not communicate to him anything about the future (P1). Another problem with market share is that it does not give any indication of what is happening in the customer's mind. It may be that the customers are shifting the attributes that they look at, but still purchasing the products produced by the firm being researched because of a price or other temporary advantage. As that

		Company	
		Good	Bad
Stock	Buy	Future not Recognized Strong future in product Markets	Weak Future In Product Markets Breakup value Earnings not the issue Other factors of valuation make the stock Underpriced. Factors other than Product market.
	Hold		
	Bad	Overpriced	False Future
	Sell	Future more than fully discounted	Poor PMP concealed by short-term factors

Figure 29

STOCKS/COMPANY AND MATRIX

advantage disappears, because of competitors actions or changed consumer attitudes, the decline in sales and earnings can be dramatic.

Another reason for the focus on the current products is that they are readily quantifiable. Most analysts want to deal with numbers. This is particularly true for those analysts working for firms that use models extensively. Models are number based and can not be expected to make any kind of subjective judgement. In cases where analysts have to defend their views to a committee, any subjective estimate, such as for products not currently on the market, becomes too difficult to justify.

Even though it is difficult to determine the actual contribution of announced, unreleased products, this becomes an important attribute to estimating earnings, particularly in industries that are experiencing shorter product life cycles. With shorter cycles, if an SBU, or the whole corporation, wishes to maintain a certain level of sales growth, it must be able to bring new products on line as the current ones begin to decline, in rates of sale growth, so that total sales and earnings will continue to reach set goals. Shorter life cycles in the product market do not affect the horizons used by analysts in their valuation or the potential holding periods for investors. Life cycles could be short and holding periods short, but the valuation method would still use a longer term horizon that would make the potential of announced, but unreleased products very important.

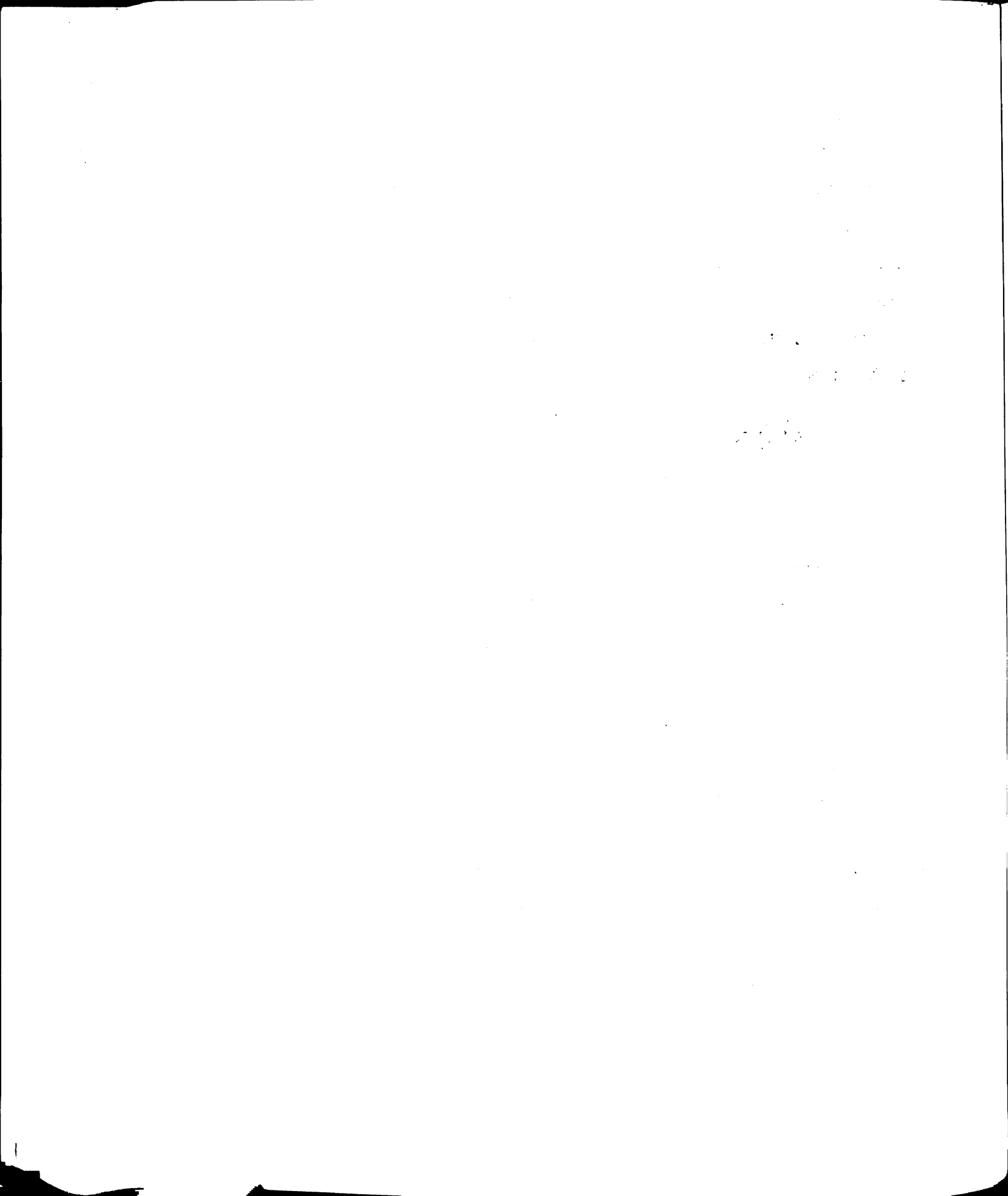
These factors may be even more important in the case of industrial products. Industrial sales for new products are often harder to develop, particularly if the firm is a new entrant into the product area. It is often difficult to gain access to the true influencers and deciders for a product class. In many industrial applications of products, the purchasing agent is only the front man for a decision process. It may take time to get back to

the technical people or the production staff that can really impact the decision. Once these contacts are made, getting the new product tested or reformulating the product to meet the standards of the user's needs may take a considerable length of time. Often in industrial sales the product not only has to meet the standards of the direct buyer, but others downstream in the channel whose product will depend on all the inputs that have gone on upstream. Several factors impact getting a product through this stage:

1. Caring--Does the purchasing company care to try the product based either on the dissatisfaction with the current company, need for second sourcing, or the reputation of the potential new supplier?
2. Cost--The cost of the new product and the cost of actually trying it out. In some operations the line must be shut down to run an experimental production with a new component.
3. Time--The time of the people that must review the new product or the actual time in testing.

There are a lot of variables that impact announced but unreleased products. To incorporate an estimate of earnings, an analyst needs some help on what kind of product acceptance to expect. The concept of presence may actually help if the product is going to be launched in a market where the company has had some experience. There appears to be a logical carryover from previous products, either positive or negative, that would be a factor in the new product risk. Some firms have such positive carryover that their stock reacts positively to new product announcements. Politicians have long recognized the importance of aligning themselves with winning candidates to receive the carryover effect.

The final area to be considered in attempting to estimate future



earnings from the product markets is unannounced products. This is even more difficult than announced products. Analysts watch the level of research and development spending as an indicator of new product development but they may not know what products are being developed. How then can analysts estimate for future products when they do not even know what those products are. Here again the overall reputation of the company in the product market may be helpful. It is important to distinguish between sales and the success of the company at being considered the standard setter in its product area. A product market performance concept, such as the proposed presence, could be very useful in developing an understanding of what kind of acceptance the products that are not even announced might expect to find in the market place.

In the drug industry one analyst indicated that they did not look at unannounced products because they were too far away from producing income and too speculative, based on the hurdles placed in the way of bringing drugs to the market by the Food and Drug Administration (K1).

-Risk

The question in the financial markets is not only future earnings but also risk. These are two inseparable components of any financial market. For example, the high return that has been observed from low P/E portfolios might be in part explained by inappropriate estimates of product market risk. Earnings for such stocks are widely known and published. The risk level can be calculated in the way that the financial market is interpreting it from any number of financial formulas. Why is it that these low P/E stocks then outperform the market? Part of this may be an inaccurate estimate of product market risk.

If a measure of risk in the product markets were available, investors might be able to appraise more accurately the value of low P/E stocks. Under the current situation there is no product market risk information available and it is difficult to estimate the ability of the company to introduce new products to the market, or the ability to move into related product areas or related markets. Currently, the earnings forecast may be viewed as risky for any number of reasons. For example, if the products are nearing the end of their life cycles, then the related earnings of the company may be at risk. Are products simply facing a declining rate of growth or are they in a real decline stage? What is the risk related to changing demographics? Estimates of future results are inherently uncertain. The more uncertainty that can be identified and quantified, the better that particular risk can be understood and hedged against.

Risk is found in all three areas of the relationship between the product and financial markets. In the financial markets there is market risk, beta, which is a measure of how the stock covaries with the market. This is based on the stocks' historic performance with the market and has no direct connection to the earnings of the company or its risk in the product markets. In fact, the effect of product market risk changes on financial market risk will probably become observable only after analysts and investors have noticed the changes in risk closer to the product markets.

Risk is also found at the specific company level. Here the risks are often financial and managerial. What is the company doing with the income stream that it is getting out of the product markets in exchange for the resources that it allocated into those areas? This kind of risk does not focus on the product market but usually picks up from the return on investment generated by the SBU or the earnings themselves. These

risks have been called operating risk and may have incorporated product market risks in an indirect way.

In looking at sales of current products, product markets are considered mainly from the behavioral aspect. A number of analysts use available services to focus on sales. Some of these services by industry studies include:

1. Drug industry--IMS.
IMS is a service that does research on prescription drugs as used in various medical facilities. It gives a good reading on the actual prescriptions that occurred at any point in time. Because of the relatively slow change in the drug market due to patent protection this has proven useful to some analysts and almost all have it available.
2. Media--Nielsen, and Arbitron
Nielsen was the most often cited as being readily available as a subscription service and also available in the newspapers for an analyst who wishes to maintain his own data bank.
3. Computers--Gartner Group, Yankee Group, and Dataquest
Gartner Group, for example, is an organization that studies the computer market by studying in detail the product, the buyers, the users, and the industry.

In addition, there were a number of smaller firms mentioned, as well as independent consultants who know what is going on in the industry. As one analyst said, if you have the right contacts, you can make a lot of money by selling your information (H1).

In looking at future risk in the product markets it is essential that all three levels of products be considered: (1) current products, (2) announced but unreleased products, and (3) unannounced products.

This is an area that analysts seem to be trying to deal with but for which there are no tools or performance measures. The concept of presence might be useful to the financial community particularly as an indicator of the strength of carryover to new products.

Short-Term Versus Long-Term Scenarios.

An evaluation of risk should be helpful whether the holding scenario is short or long term. In chapter one, attention was paid to the importance of the long term holding stockholder and the maximization of shareholder wealth. It was felt that if marketing strategy were to be fully appreciated it would be in the long term because it takes time for the marketing investment to turn first into sales and then into income. As a result of the interviews, the holding period seems to be of less importance and the valuation periods much more important. The market reacts quickly to new information that indicates that sales, and presumably earnings, will change positively or negatively from that currently being forecast by the consensus. Any tool that provides additional information or an earlier indication of which way things are likely to move may allow an analyst to move slightly ahead of the crowd--this is the non-consensus position that all analysts are seeking to be able to support so that their portfolio managers can outperform the market.

The financial markets exist in today's format because there are differences in buyers' and sellers' estimates of uncertainties and their impacts. An accurate assessment of product market risk would allow analysts to better appraise new corporate information and how macro market influences might impact the specific company in question. Currently the problem seems to be that there is no quantifiable measure of market uncertainty that financial analysts can use.

One of the ways in which an indicator of product market risk could help is that it would allow analysts to distinguish between companies of similar risk and return, based on currently available measures. Companies that seem to be of equivalent risk and return, using the historically based

measures, might look very different if the variance in product market risk could be identified.

Presence Is an Intangible Asset Like Goodwill.

Presence may be considered as an intangible asset like goodwill by analysts. A dictionary definition of goodwill is:

The favor or advantage in the way of custom that a business has acquired beyond the mere value of what it sells, whether due to the personality of those conducting it, the nature of its location, its reputation for skill or promptitude or any other circumstance incidental to the business and tending to make it permanent. (Webster 3rd)

An accounting definition of goodwill is basically the market value of a firm at the time it is sold less the book value of the firm, or the excess paid over book. This concept is sometimes referred to as "going business value," a holistic recognition that a going business should have some value over and above its net asset value. An important element of this is the customers' perception of the firm and its products, or presence. Goodwill could in fact be made up of a number of things, not the least of which would be presence. Goodwill also could only be a portion of presence as shown in the Venn diagram (see Figure 30).

Low product market risk is the result of marketing investment. Success in developing product markets is normally measured in the most tangible form available--sales. The residual impact of marketing investments, with carry-over effect in lowering product market risk is intangible and difficult to quantify but important to the whole concept of the company's future position in the product market. One of the analysts discussed the number of intangibles there were in the process of valuation

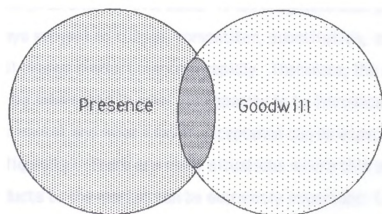


Figure 30

PRESENCE/GOODWILL VENN DIAGRAM

and how much any quantification of these would be helpful (P1).

Product Market Risk Factors Used by Financial Analysts.

There are a number of different ways that analysts have attempted to wrestle with the product market risk concept. A clear support of the concept occurs in the case where an analyst felt that a company's stock price should remain high in expectation of future product market success even though in its current situation the company had a declining rate of sales. The market and the analyst apparently were willing to count on past generated product market strength carrying over into new product sales when present problems are overcome. It is recognized that product markets are always subject to change; competition, substitution, and technology can all change product markets rapidly. Therefore, the analyst of a company has been interested in what its capacity is to introduce new products into the market and what kind of acceptance can be expected (product market liquidity). There are many situations where this ability to bring new products to the market can be extremely important: (1) product gap, (2) external threat, (3) internal threat, (4) product life cycle failure for class or brand, and (5) problems with product quality control, that is, performance reliability.

In the case of product gap an SBU may find that its product line is entering the decline phase and it is not ready to introduce a new product. Sales or profits may be falling or simply not increasing at the same rate as expected. A company may continue to have increasing sales but at a decreasing rate as customer perceptions turn away. Competition may pick up to the level where margins and profits have to be reduced to compete. These factors may arise because of a shorter product life cycle than

expected or a delay in being able to get new products ready for the market. Companies are rightfully hesitant to introduce a new product or product modification to the market before they are completely ready in the areas of quality performance and availability. This could lead to a substantial increase in product market risk, a decrease in presence, that the firm has among customers if the product did not perform up to their expectations. Further it could carry-over to related lines as well. Some companies in the past have made the mistake of sending a product to market with the idea that they would later provide the refinements necessary--this has frequently caused problems.

The analysts provided examples of where they felt product gap was occurring. In one case, Hewlett-Packard was described as being in a product gap situation because its new line was not coming out for some time. The analysts pointed to the weakness in the stock at the time but said it would not fall further because the new product introduction was expected to benefit from carryover of the company's record with customers (G1). A second example was provided in the media area, where Dow Jones was described as having reached a level of saturation indicating market maturity and a reasonably stable market for the future. There was concern as to the ability of the company to continue to generate superior growth in sales and earnings with the current products (H2).

External threats may cause problems in the product market from a number of possible directions: product scares (Tylenol: K1), bad publicity (tobacco), regulatory problems (asbestos), foreign competition, and currency risk. Any of these may cause difficulty for a specific product or SBU as well as for the whole company. Regulatory problems could be demonstrated by patent infringement cases such as the one that forced

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Kodak's recent removal of their entry into the instant camera field.

Companies which have a high measure of presence should have a better ability to meet the challenge of an external threat. This is, in a sense, using some of their marketing capital.

Internal threats may occur due to a loss of key personnel through illness or accident, as a result of prolonged labor strife, or from obvious internal dissension. The question is, "Will the strength of the product presence carry the firm through the transition period?" These factors may have less direct impact on the product market than they do on the corporate presence in the financial market. It would appear that, in addition to the presence that is built up in the product market, there is the same sort of composite in the financial markets.

Occasionally a new product launch is a disaster, either for the brand or in the whole product class. A firm that has presence in the market place should be able to bring other products to the market with relative ease as long as they are products related to its existing product lines or markets. If it lacks strong presence to hold its customer base, there may be no second chance to bring a product to market. New companies that are part of a product class that fails often have a very difficult time because they do not have the marketing capital developed in the form of presence.

Occasionally even those companies who are favored by consumers as being the standard will run into difficulty with quality control on a product--either a new line or a new plant. A firm with presence will normally be allowed time to correct the problem. As the problem persists, however, the firm will be depleting its presence or product market capital. Customers can redesignate the standard, passing it to another product for several reasons. High among these is product performance, (quality):

slipping quality in the original product; and, better performance in the competitors product.

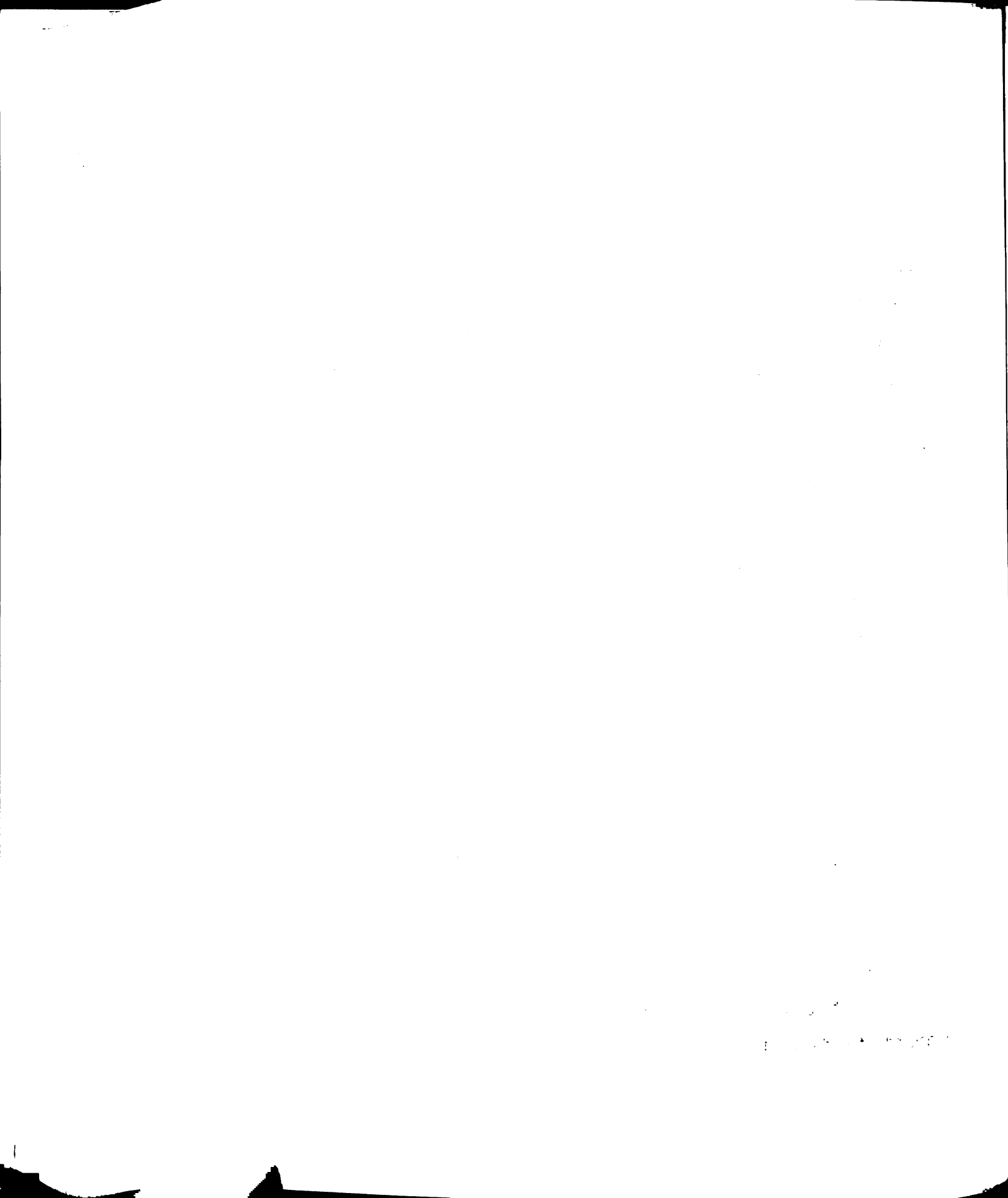
In summary, there are a number of reasons why product market risk measures would be useful to analysts who are trying to understand the performance of companies in the financial markets. The product markets may be able to provide some information that would be particularly useful to the financial community in estimating risk of future earnings. This will require development of a more refined theory and actual measures but the first steps, however, have been taken with the model of the relationship as presented. The financial analysts interviewed contributed significantly to the development of this model.

Product Market Risk and Marketing Strategy

The product market risk concept can be very important to the job of the marketing vice president and to those individuals responsible for the management of an SBU. A measurement of product market risk could be useful, as a strategic tool and as part of a compensation system.

Presence and Market Definition

A measure based on customer perception is less sensitive to changing market definition than would be market share or some of the other sales based measures. The manager can always watch the direction that the customers are moving (Haley and Gatty, p. 66). The measure itself should be sensitive to changing market definition as it will have to include some indication of the attributes by which the product is being judged the standard. If it does not, it will fall prey to the same kinds of problems that market share faces in being at the discretion of management for



definition (Henderson, Corporate Strategy)

The concept of presence could help with marketing myopia (Levitt, The Marketing Imagination, p. 8). Because the concept is sensitive to increasing product substitutes or changing standards in the mind of the customer, the shift in customer perceptions should show up long before the shift in customer behavior is noted in sales. One of the analysts gave the example in the media area: despite the franchise that many newspapers have, they have to be wary of possible changes in consumer patterns (behavioral), or consumer thinking (cognitive and affective). For example, in the media industry, the evolution of new ways of distributing advertising such as the Penney Saver, Flashes, and home delivery by services other than the post office, may provide competition for newspaper advertising dollars. Similarly, on the television, the ability to eliminate advertisements using video cassette recorder may impact those advertising dollars. The point, as was suggested by Levitt, is that no industry is invincible. It is time to develop a performance measure that tells something about how a firm is doing at maintaining its place in the market (H2). Some time may elapse before slippage in standard measures or substitutions in evoked sets, is reflected in sales and profits. The use of a concept such as presence to measure product market risk can help to avoid marketing myopia for the manager as well as for the analyst and can provide precious lead time in problem identification and solving.

Presence and Related Marketing Concepts

Presence differs from other marketing concepts. As a measure of product market risk it helps with strategy outside the product market and helps refine the choices within the product markets. Some of the concepts

that might be confused with presence include: brand loyalty; reputation; competitive advantage; and, sustainable competitive advantage.

Presence differs from brand loyalty in the way that the two concepts are conceived. Brand loyalty is the repetitive purchasing of a brand of a product. It can come from the same consumers buying the product or from the same percentage within the sample area buying the product. Brand loyalty is built on the behavioral notion of the number of repeat sales of the product (Kotler, 1980, pp. 305–306). There is no component of presence as conceived that deals with past sales. Presence is future oriented. As conceived, presence reflects customer perceptions in relation to the need or want to be fulfilled as opposed to analyzing sales patterns. Potentially a product brand could have some developing presence in a related product class or form even though no product entry currently exists. This would not be true for brand loyalty that requires the sales to develop the loyalty (IBID).

Presence differs from product reputation. Reputation is the overall quality or character of a product as seen by people in general. A measure of presence would be an attempt to measure a set of elements of this generality and exploit them in marketing strategy,

Product strength as in the General Electric Portfolio Model (Peter, et al., 1985, p. 29) differs from presence as it is not based on customer perceptions, but rather on management's expectations. It does not contain the measures of awareness, evoked set, and standard that are suggested elements of presence. Most of the items that are considered are historical as can be seen in Figure 31.

Industry Attractiveness	Business Strength		
	Strong	Average	Weak
High	A	A	B
Medium	A	B	C
Low	B	C	C

Components of Industry Attractiveness and Business Strength
at General Electric

Industry Attractiveness

Market Size
Market Growth
Profitability
Cyclicality
Ability to recover
from inflation
World Scope

Business Strength

Market Position:
Domestic market share
World Market Share
Share Growth
Share Compared with
leading competitor
Competitive Strengths
Quality leadership
Technology
Marketing
Relative Profitability

Figure 31

GE PORTFOLIO MODEL

Finally presence differs from competitive advantage. Coyne states:

For a producer to enjoy a competitive advantage in a product/market segment, the difference or differences between him and his competitors must be felt in the marketplace: That is they must be reflected in some *product/delivery attribute* that is a *key buying* criterion for the market. (Coyne, p. 55)

A competitive advantage, then, could be something such as lower cost production (Porter, 1980, p. 35) if price was a key attribute. It could be distribution system, product quality as preserved by patentable technology, and so forth. Presence differs from this definition of competitive advantage in that it is based on customer's perceptions. Therefore, a firm may achieve a competitive advantage in a product even though the customers have been moving away from the product class or form. Given the current state of technology, competitors can easily acquire similar technical processes unless it requires a long government approval period that would not be duplicable or replaceable (Hayes, 1985). Presence is focused on the customer and the direction that the customer is moving in terms of future purchases. A firm could have competitive advantage and not recognize that the market was moving away -- this would be visible, using a measure of presence.

In addition to cost leadership, Porter (1980) discussed differentiation and focus as generic strategies. Differentiation is defined as "something that is perceived industry wide as being unique," (IBID, p. 37). This does not address product market risk. Differentiation may or may not lead to greater stability. Focus is built around a particular target market (IBID, p. 38). Again, this may not lower product market risk and may, in fact, increase it by limiting customer awareness even though it increases current sales and profits.

Kotler views competitive advantage as a customer oriented concept in the product markets. It refers to the way(s) "in which a firm favorably distinguishes itself or its products in the eyes of its customers,"(Kotler *et al*, p. 246).

There are many possible ways that a firm can distinguish itself or its products through distinctive competencies. It is only when this distinction is perceived by customers to be of value that a competitive advantage is created (IBID, p. 247).

Competitive advantages could be perceived in any number of areas including but not limited to:

- | | |
|--------------------|-------------------------------|
| 1. Price | 6. Reliability |
| 2. Quality | 7. Functionality |
| 3. Maintainability | 8. Personal Image Enhancement |
| 4. Service | 9. Terms (financing) |
| 5. Location | 10. Availability |
| | 11. Lower Production Cost |

Since competitive advantages are customer-based, any particular competitive advantage is:

...likely to reside in the specific nature of a particular project rather than the broad characteristics of the particular business decision that is sponsoring it. (Wensley, p. 79)

The importance of developing competitive advantage and thus pleasing customers is underscored by Levitt:

...a customer is an asset usually more precious than the tangible assets on the balance sheet. (Levitt, 1983, p. 91)

Gluck, Kaufman, and Wallick, in talking about strategically managed

companies, emphasize the importance of competitive advantage. The generation and sustenance of a competitive advantage is an entrepreneurial activity (Kotler *et al*, p. 247). This is because a strategy not predicated on some degree of entrepreneurial (disruptive) content is merely a replication of what competitors are doing (IBID). Firms developing strategies aimed at sustainable competitive advantage have a commitment to creating their own future (Gluck *et al*, p. 161) which involves changes in the status quo, such as:

...introducing new products, modifying existing products, altering the conception of the product in the customer's mind, changing modes of competition, pursuing new customers, and so forth. (Kotler *et al*, p. 247)

This is true marketing as opposed to a sales orientation since developing competitive advantage is a long run proposition. Some examples of the development of competitive advantage include:

1. Innovative design which reduces labor cost and therefore allows the product to be more price competitive.
2. Changing the sales approach. For example, changing the way in which machine tools are sold from an engineering perspective to a technically and financially argued sales approach to top management. (Gluck *et al*, p. 161)

Competitive advantage refers to the distinctive competencies of a firm that are of value to its customers. This leads to the creation of a market position that is unique for that firm.

It has been suggested (Kotler *et al*, 1985, pp. 231-232) that firms should guide their marketing investments by reviewing what competitive advantage they have, at what rates they are losing or gaining, what is required to sustain the competitive advantages they have, and what is needed to overcome the disadvantages. They propose an advantage-time

1997, 1998, 1999, 2000, 2001, 2002, 2003, 2004, 2005, 2006, 2007, 2008, 2009, 2010, 2011, 2012, 2013, 2014, 2015, 2016, 2017, 2018, 2019, 2020, 2021, 2022, 2023, 2024, 2025, 2026, 2027, 2028, 2029, 2030, 2031, 2032, 2033, 2034, 2035, 2036, 2037, 2038, 2039, 2040, 2041, 2042, 2043, 2044, 2045, 2046, 2047, 2048, 2049, 2050, 2051, 2052, 2053, 2054, 2055, 2056, 2057, 2058, 2059, 2060, 2061, 2062, 2063, 2064, 2065, 2066, 2067, 2068, 2069, 2070, 2071, 2072, 2073, 2074, 2075, 2076, 2077, 2078, 2079, 2080, 2081, 2082, 2083, 2084, 2085, 2086, 2087, 2088, 2089, 2090, 2091, 2092, 2093, 2094, 2095, 2096, 2097, 2098, 2099, 2100, 2101, 2102, 2103, 2104, 2105, 2106, 2107, 2108, 2109, 2110, 2111, 2112, 2113, 2114, 2115, 2116, 2117, 2118, 2119, 2120, 2121, 2122, 2123, 2124, 2125, 2126, 2127, 2128, 2129, 2130, 2131, 2132, 2133, 2134, 2135, 2136, 2137, 2138, 2139, 2140, 2141, 2142, 2143, 2144, 2145, 2146, 2147, 2148, 2149, 2150, 2151, 2152, 2153, 2154, 2155, 2156, 2157, 2158, 2159, 2160, 2161, 2162, 2163, 2164, 2165, 2166, 2167, 2168, 2169, 2170, 2171, 2172, 2173, 2174, 2175, 2176, 2177, 2178, 2179, 2180, 2181, 2182, 2183, 2184, 2185, 2186, 2187, 2188, 2189, 2190, 2191, 2192, 2193, 2194, 2195, 2196, 2197, 2198, 2199, 2200, 2201, 2202, 2203, 2204, 2205, 2206, 2207, 2208, 2209, 2210, 2211, 2212, 2213, 2214, 2215, 2216, 2217, 2218, 2219, 2220, 2221, 2222, 2223, 2224, 2225, 2226, 2227, 2228, 2229, 2230, 2231, 2232, 2233, 2234, 2235, 2236, 2237, 2238, 2239, 2240, 2241, 2242, 2243, 2244, 2245, 2246, 2247, 2248, 2249, 2250, 2251, 2252, 2253, 2254, 2255, 2256, 2257, 2258, 2259, 2260, 2261, 2262, 2263, 2264, 2265, 2266, 2267, 2268, 2269, 2270, 2271, 2272, 2273, 2274, 2275, 2276, 2277, 2278, 2279, 2280, 2281, 2282, 2283, 2284, 2285, 2286, 2287, 2288, 2289, 2290, 2291, 2292, 2293, 2294, 2295, 2296, 2297, 2298, 2299, 2300, 2301, 2302, 2303, 2304, 2305, 2306, 2307, 2308, 2309, 2310, 2311, 2312, 2313, 2314, 2315, 2316, 2317, 2318, 2319, 2320, 2321, 2322, 2323, 2324, 2325, 2326, 2327, 2328, 2329, 2330, 2331, 2332, 2333, 2334, 2335, 2336, 2337, 2338, 2339, 2340, 2341, 2342, 2343, 2344, 2345, 2346, 2347, 2348, 2349, 2350, 2351, 2352, 2353, 2354, 2355, 2356, 2357, 2358, 2359, 2360, 2361, 2362, 2363, 2364, 2365, 2366, 2367, 2368, 2369, 2370, 2371, 2372, 2373, 2374, 2375, 2376, 2377, 2378, 2379, 2380, 2381, 2382, 2383, 2384, 2385, 2386, 2387, 2388, 2389, 2390, 2391, 2392, 2393, 2394, 2395, 2396, 2397, 2398, 2399, 2400, 2401, 2402, 2403, 2404, 2405, 2406, 2407, 2408, 2409, 2410, 2411, 2412, 2413, 2414, 2415, 2416, 2417, 2418, 2419, 2420, 2421, 2422, 2423, 2424, 2425, 2426, 2427, 2428, 2429, 2430, 2431, 2432, 2433, 2434, 2435, 2436, 2437, 2438, 2439, 2440, 2441, 2442, 2443, 2444, 2445, 2446, 2447, 2448, 2449, 2450, 2451, 2452, 2453, 2454, 2455, 2456, 2457, 2458, 2459, 2460, 2461, 2462, 2463, 2464, 2465, 2466, 2467, 2468, 2469, 2470, 2471, 2472, 2473, 2474, 2475, 2476, 2477, 2478, 2479, 2480, 2481, 2482, 2483, 2484, 2485, 2486, 2487, 2488, 2489, 2490, 2491, 2492, 2493, 2494, 2495, 2496, 2497, 2498, 2499, 2500, 2501, 2502, 2503, 2504, 2505, 2506, 2507, 2508, 2509, 2510, 2511, 2512, 2513, 2514, 2515, 2516, 2517, 2518, 2519, 2520, 2521, 2522, 2523, 2524, 2525, 2526, 2527, 2528, 2529, 2530, 2531, 2532, 2533, 2534, 2535, 2536, 2537, 2538, 2539, 2540, 2541, 2542, 2543, 2544, 2545, 2546, 2547, 2548, 2549, 2550, 2551, 2552, 2553, 2554, 2555, 2556, 2557, 2558, 2559, 2560, 2561, 2562, 2563, 2564, 2565, 2566, 2567, 2568, 2569, 2570, 2571, 2572, 2573, 2574, 2575, 2576, 2577, 2578, 2579, 2580, 2581, 2582, 2583, 2584, 2585, 2586, 2587, 2588, 2589, 2590, 2591, 2592, 2593, 2594, 2595, 2596, 2597, 2598, 2599, 2600, 2601, 2602, 2603, 2604, 2605, 2606, 2607, 2608, 2609, 2610, 2611, 2612, 2613, 2614, 2615, 2616, 2617, 2618, 2619, 2620, 2621, 2622, 2623, 2624, 2625, 2626, 2627, 2628, 2629, 2630, 2631, 2632, 2633, 2634, 2635, 2636, 2637, 2638, 2639, 2640, 2641, 2642, 2643, 2644, 2645, 2646, 2647, 2648, 2649, 2650, 2651, 2652, 2653, 2654, 2655, 2656, 2657, 2658, 2659, 2660, 2661, 2662, 2663, 2664, 2665, 2666, 2667, 2668, 2669, 2670, 2671, 2672, 2673, 2674, 2675, 2676, 2677, 2678, 26

[illegible]

plane, Figure 32. The firm should allocate its resources to find ways to level out slopes or even make the slope go up from left to right: increasing competitive advantage over time.

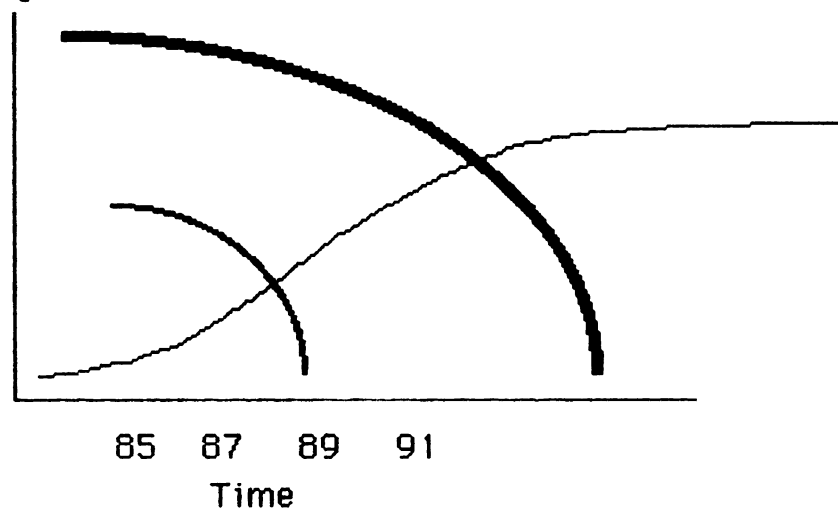
Coyne has not defined sustainable competitive advantage but describes the condition under which it exists.

1. Customers perceive a consistent difference in important attributes between the producer's product or service and those of his competitors.
2. That difference is the direct consequence of a capability gap between the producer and his competitors.
3. Both the difference in important attributes and the capability gap can be expected to endure over time. (Coyne, p. 55)

This special case of competitive advantage would be expected to have lower product market risk. However, it is not the same as low product market risk or presence. Presence implies the ability to carry the advantage over to new product in the future in related areas; this is an indication of true product market stability.

In general, those focusing on competitive advantage would appear to be reacting to the current market situation, a reactive strategy. The focus of many authors that discuss competitive advantage is the neoclassical orientation of Porter and Coyne. These focus on the tangible product and its relationship to the current product market and extant competition. A marketing concept approach would be more likely to focus on the product core or intangible product. The pursuit of presence would be a proactive strategy based on creating a stable market position.

All of these concepts--brand loyalty, reputation, competitive advantage, sustainable competitive advantage have elements that point to



- Desired Pattern
- Product A
- Product B

The firm should allocate its resources to find ways to level out slopes or even make the slope up from right.
Source: Kotler, et al, p. 237

Figure 32
ADVANTAGE TIME PLANE

what is expected in the future and contribute to the formation of presence in the mind of the consumer. The sense of presence would incorporate these effects in its wider view of consumer cognition and affective motivation.

The Concept of Presence as a Performance Measure

If carry-over market strength can be measured as conceptualized in presence, it has real potential for playing a role in the evaluation of management. The manager whose evaluation and compensation are partially based on a measure of future market strength, as well as other performance measures, would naturally have more inclination to be concerned about the future. Presence should be useful as an indicator of basic market strength which may help with the introduction of new products in the future in either related product categories or related markets. A measure of product market risk might be an indicator of what the manager has achieved in the way of flexibility.

Managers at the SBU level have to be very concerned with the product market risk in order to allocate the resources they are provided to maximize the return from the market. Current profits at the cost of exhausting marketing capital is questionable. The concept of presence would provide a means of addressing that residual product market strength.

At the corporate level, a knowledge of product market risk would be very important in helping evaluate how managers of units are doing and how marketing management is doing in preparing the company for the future. It would also be important, as mentioned above, in avoiding marketing myopia. A performance measure based on product market risk

should tend to make management more sensitive to changing market conditions in technology, customer attributes, and so forth. Examples in technology include: tubes to semiconductors, steel to aluminum to plastic. Examples in customers attributes include: style changes, smoking to nonsmoking, and fat to thin. This sensitivity to changing marketing standards either away from the company's product or to it could be very useful in properly evaluating management.

A measure of product market risk would be useful in conjunction with the traditional sales-based measures; market share, and growth rate. It would not replace these tools which have been so useful in the past, but instead provide another dimension and additional insight into the planning process. The traditional models are sales based and therefore historical and behavioral. Product market risk, in contrast, is focused on expected carryover from the present into the future. It is this future capacity that should interest both management and analysts alike.

Current sales are only a partial measure of the success of market investment. A measure to determine residual market strength or carry-over affect of marketing strategy is needed. Marketing investment should lead to a better value for the company in the product market. There are two ways to improve the value in the product market: lower risk or higher return, or both. Most of the measures available to the marketing manager measure return related functions, but the concept of presence addresses risk in the product market place. If risk can be reduced in the product market place, it will reduce the volatility and allow for better planning. Thus, a product market performance measure would be extremely helpful to the marketing manager in opening up new ways to measure the effect of marketing investment. It may be possible that, for

any given product, product market risk can be equated to profit, which would begin to provide a measure of the cost effectiveness of varying marketing methods.

In terms of achieving long term management goals, a system that would identify, even in a general way, competitive weakness, market environmental changes, and the direction of movement in the customers' cognitive and affective states, would enable an adaptive marketing strategy. To know the status is important but to know the direction of changing customer perceptions would indicate achievements long before the sales take place.

In summary, there are a number of ways that a performance measure based on product market risk may be useful to management: to help with its evaluation of its plans and objectives and the level at which they are being met.

Presence as a Strategic Tool.

In concept, presence has the potential to be an important strategic tool to managers. It would indicate competitive success and the success of resource allocation. It would also suggest the way in which future resources should be allocated.

If it is assumed that the company desires to achieve continuous growth in sales and profits, an understanding of product market risk would be very useful.

One area of concern would certainly be flexibility in product markets. If a firm has established low product market risk, it should have more market flexibility than a competitive firm that has not achieved the same level. Specifically, it should be easier to introduce new products and

market share should be obtainable through market strategies.

To maintain increasing levels of sales, management must be concerned with the ease of new product introductions, especially as product life cycles shorten. If growth is to be maintained, new products must be accepted at the rate that they are planned for, so that management does not find itself in a product gap with the rate of sales growth falling. New products should be timed to enter the market so that their growth phase would develop at the point at which the previous product would begin to slow in its rate of growth or enter maturity.

Low product market risk in any given area may indicate that the firm could use the same channels to distribute new related products--or reach related markets through those same channels. Since rate of profit growth can reasonably be predicted from a rate of sales growth, an indicator of low product market risks would be an indicator of the probability of meeting management profit goals.

A measure of product market risk would enable management to time better its new entries to maximize its situation. For example, a firm that is in a low product market risk situation in a related product may let other firms develop the new product class and then enter the competitive phase of the life cycle, knowing that it will have a chance to have its market share. If the same firm did not have low product market risk in related areas it would be advised to enter the product class early before customers begin to form their perceptions. Thus, firms with low product market risk may be allowed the luxury of waiting in a new product introduction, waiting until they feel that they have an improved product, or simply waiting to learn from the pioneers' mistakes.

If the goal is market share immediately, as opposed to growth of

sales, then a customer-based measure of perception such as was suggested for presence can also help the strategist recognize some of the problems of a market share strategy as they are developing. One of the obvious dangers of market share strategy is the risk of poor performance. In the rush to sell more of a product, there is the inherent risk that they will not be successful at delivering quality. Another factor that management has to worry about in the market share strategy is what the trade off is. A firm may obtain immediate dollars and market share by reducing price, but what will that mean for the future? If the standard is moving elsewhere, then the market share strategy will not buy long term share but temporary share which may not be worth the price being paid.

The strategies for the different levels of product will be impacted by market risk. In the case of current products a low risk provides product market flexibility. The case of Hewlett-Packard, which, as mentioned by one analyst, has been discussed above. Essentially, even though they were facing a product gap, the investment community believed that they had the ability to bring out new products and gain market acceptance based on their past successes. This belief that for Hewlett-Packard the product market risk was low was helping to bolster the stock. Further, if the investment community is correct, Hewlett-Packard was in a strategically better position than firms that have not obtained the level of market presence that they have achieved.

Product market risk clearly impacts strategies in current life cycles. It helps avoid marketing myopia because it should cause management to look at the customer in a way that looks behind the sales to the cognitive and affective states. The impact can be seen by looking at the difference between the two B.C.G. models, one with and one without presence (see

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...the third step in the process of...
...the fourth step in the process of...
...the fifth step in the process of...
...the sixth step in the process of...
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...the ninety-first step in the process of...
...the ninety-second step in the process of...
...the ninety-third step in the process of...
...the ninety-fourth step in the process of...
...the ninety-fifth step in the process of...
...the ninety-sixth step in the process of...
...the ninety-seventh step in the process of...
...the ninety-eighth step in the process of...
...the ninety-ninth step in the process of...
...the hundredth step in the process of...

Figure 33).

In the case of low presence, a star is likely to be much weaker because there is no reason to expect that the SBU can be successful at bringing out other products in the same area successfully. Analysts spoke about this when they said that Apple did not have room for the mistake that it made in some of its product introductions--noticeably Lisa. A star that does not have the perception of being the standard, risks having a competitor enter the market and quickly change the composition of the market, particularly if that competitor is able to achieve the customers' perception of standard. Such a competitor can probably obtain technology and market share in a short-term (Hayes).

Similarly, a weak question mark without presence is in trouble. It may only be a question mark because it is concealed by market growth but, as soon as companies that have better customer perceptions enter the field, the SBU with a question mark product is likely to find that it is in real trouble. This has been seen in industries where start up companies were later replaced by companies that had the advantage of presence (low product market risk) in related markets that entered and took over the market.

A cash cow without presence may really be a sick cow and should be looked at carefully to see if it can be harvested while the opportunity is available. Being a cash cow implies that the company is in a mature industry and that growth, to some degree, stabilized since the growth rate is low for cash cows and dogs. If this is the case, and the SBU has not achieved presence, it is unlikely to fare well in the coming price competition of the maturity and decline phases of the product life cycle. A company without presence, has little to put up against a competitor's

B.C.G. Model and
Low Presence

Market Growth Rate

Weak Star Falling Star	Weak Question Mark
Weak Cow Watch out for competitin	Sick Dog

Market Share

B.C.G. Model and
Strong Presence

Market Growth Rate

Strong Star Watch out for substitues	Strong ? Should be able to move to star
Extremely Strong Cow	Strong Dog

Market Share

Figure 33

BOSTON CONSULTING GROUP MODELS



low price, when competing with a product that has presence, and therefore, may face substantial market risk.

A dog that does not have presence is really ill. Since it has neither market growth nor market share and is probably in the decline stage or maturity, if it does not have the customers' perception of quality, it is not likely to succeed. This has been seen in a number of industries where the smaller competitors are consumed or put out of business by those that the customers are using as the standard. If the smaller companies were considered the standard they should be able to compete, even though charging a slightly higher price to make up for lower volume, higher production costs.

In contrast, if the BCG is looked at in terms of low product market risk, a very different picture emerges for those firms with strong presence. A strong star has all the advantages: growth rate, share and a large potential customer base that allows it to take advantage of using the experience curve and bring its prices down. These firms have to watch out for eroding presence or the development of product substitutes. This would probably be seen first in the attributes that make up the standard.

A question mark with the benefit of strong presence should be able to move into the star category. If there is cognitive and affective customer perception, it should be able to convert that into additional market share. The difference between a star with presence and without presence is the difference between building a strategy for success for the future and trying to build a strategy for survival.

A cash cow with strong presence is extremely strong. The implication is that it is in a stable industry because of the lower growth rate and additionally it has market share and is the standard for

consumers. Such a cash cow can truly be used for the cash it generates. A continuous measuring of product market risk would keep management appraised of any changes in the customers perceptions before trouble shows up in the behavioral area, sales. This is the kind of thing that could prevent a negative from going so far that it would eventually impact sales. A dog that has strong presence may not be a dog at all. It may just be a small participant in a product market that has strong consumer strength. Before thinking about divesting or investing, the dog with more money management may want to understand what level of product market risk they face.

Thus, presence, if it can be measured, would provide new insights in the way that management should look at the BCG as a tool. Marketing promotion may be used to improve sales and market share but building a product standard in the customers' perception leads to longer term strength (risk reduction) for current and future products. The new information that would be provided can help in two ways. The first is in making decisions relative to the model. The second is in making strategic decisions that may be favorably interpreted in the financial markets and therefore work toward the corporate goal of maximizing shareholder wealth.

The General Electric Grid comes closer to encompassing the concept of presence than does BCG but in its strength measures it is not considering how the customer perceives product standard. This is a key difference, especially when it is combined with the other customer based areas that are part of presence.

It is important to remember that presence is really the result of an effective marketing concept being put in to practice. This should reduce

risk and increase returns. The whole concept is based on the customers and their perceptions. The assumption is that, at least in part, the future in the product markets is determined more by what customers think about products today than what they purchased yesterday. Politicians are keenly aware of this and are always using the benefits of polls to test voter (consumer) perceptions.

Given this assumption, it makes sense to develop a product market risk performance measure for management, that is based on customers and how they think. It is also important, particularly if the link between what is occurring in the product markets and the financial markets is to be developed, by having some way of measuring the implications for the future from current performance

Having a low product market risk is significant in planning for future products. The carry-over of one product to another is important to the successful introduction of new products into the market. The carryover can be a real advantage to a firm that wishes to enter a related product or market to the firm. One of the strategic issues where presence may be particularly useful is preparing for new products to pick up the growth as the PLC for current product flattens or declines.

An understanding of product market risks and the concept of presence can be very useful in bringing out new products in current markets. New products can be classified in one of the three following ways: (1) new function, (2) new technology, and (3) new customer group.

If the new product is offering a new function to an existing customer group which already has a strong affective position for the old product and thinks of it as a standard, then the introduction of the new product should be readily acceptable to the customer base if they see a need for its

function. If the new product is new technology, then presence should help even more with the acceptance since new technology might normally force a customer into extensive problem-solving, but if the firm's existing product has obtained presence it should carry over to the new product, helping to reduce the decision to limited problem-solving or even routine response. Presence is also useful in introducing old products to new customer groups. A measure of product market risk could be used as a performance evaluation tool, thus management could determine what kind of success is being achieved. Also, the concept of presence would indicate that, if the new customer group could be related to the old customer group, then the introduction should be easier. This has to do with the positive impact of influencers on the decision process.

An understanding of presence could also be very useful in considering strategic decisions using the product market matrix (PMM). One way in which it helps is that it provides guidance about which products to bring to the market. Once the concept of looking beyond sales has been recognized, then the importance of the cognitive and affective state of the customer begins to take on importance. Building a strong affective case in customers takes time and marketing investment. Wherever new product introductions can include ways of using this advantage where it exists, it should. Thus, given a set of products being considered for introduction, the manager may wish to look carefully at those that are related to a current product line where an indication of presence has been established--no matter what the sales are currently. The assistance that presence might give a product entering a related market or product area is based on the importance of the customer perception. The introduction will, to some degree, risk the intangible marketing capital that has been

accumulated by the firm or brand.

Knowledge of product market risk would also indicate a strong case for family branding as long as a unit had one or more products that seem to be achieving presence. There are conditions that should be looked at before making the family branding decision on the basis of presence:

1. Greater advertising efficiency
2. Comparable product quality--you do not want to endanger the presence for the products that achieved it. (Davis, Marketing Management p. 328)
3. Consumer groups--or related groups that use all products sold under the brand name
4. Potential financial market response

In order for presence to have much help in the case of family branding, it is important that conditions two and three be met.

The nature of the life cycle, in particular the length of the life cycle, may determine how or why low product market risk is important in the SBU strategy. In the case of products with shorter life cycles, low risk becomes important for new introductions to keep the overall growth of sales and profits for the firm at the desired level. If low product market risk makes the new product introductions simpler, then having it could be crucial to meeting the target goal of the organization.

In the case of products with longer lifecycles, a concept such as presence can be very useful in terms of determining the product position in the mature and decline stages. A product that has the customer cognitive and affective market should be able to obtain the behavioral market in the later stages of the life cycle if their costs are similar to those of other companies in the market.

Presence may also be useful to marketing strategists in reformulating

the product market matrix. The traditional matrix (as shown in Figure 34) uses old or new products and old or new markets. A meaningful refinement that may help determine strategic moves is shown in Figure 35. Note that products or markets move from current to related and finally to altogether new. This adds some significant possibilities to the strategic thinking process.

1. Related Market Development

This refers to taking the same product into a related market. Presence is believed to have a strong carry-over into related customer groups. If an SBU has achieved low product market risk as indicated by the performance measure, then it should discover that it can penetrate markets that are related with lower risk. This would start a new life cycle as discussed above because it is dealing with a new customer group.

2. Related Product Developments

This refers to taking a related product to the same customer group. It could be a modification of the product in form or technology. Presence would help in this case because an SBU that had been successful at achieving presence should find that customers were willing to consider more products by the same firm, particularly if they are in the same area.

3. Synergistic Development

This refers to taking a related product to a related customer group. In this area, the more related the product and the customer group are, the more impact that presence will have. This is using carryover in both the customer and the product area. It differs from diversification, which implies entering into entirely new markets where the company has no customer base and no existing product.

Thus, presence or low product market risk, provides a new way of viewing the product market matrix that may help management to make better decisions. It would seem that the SBU with low product market risk would have the best chance at attempting to do something in one of the four shaded quadrants in Figure 36. These are the areas in which the most carry-over from existing presence in the customer markets should

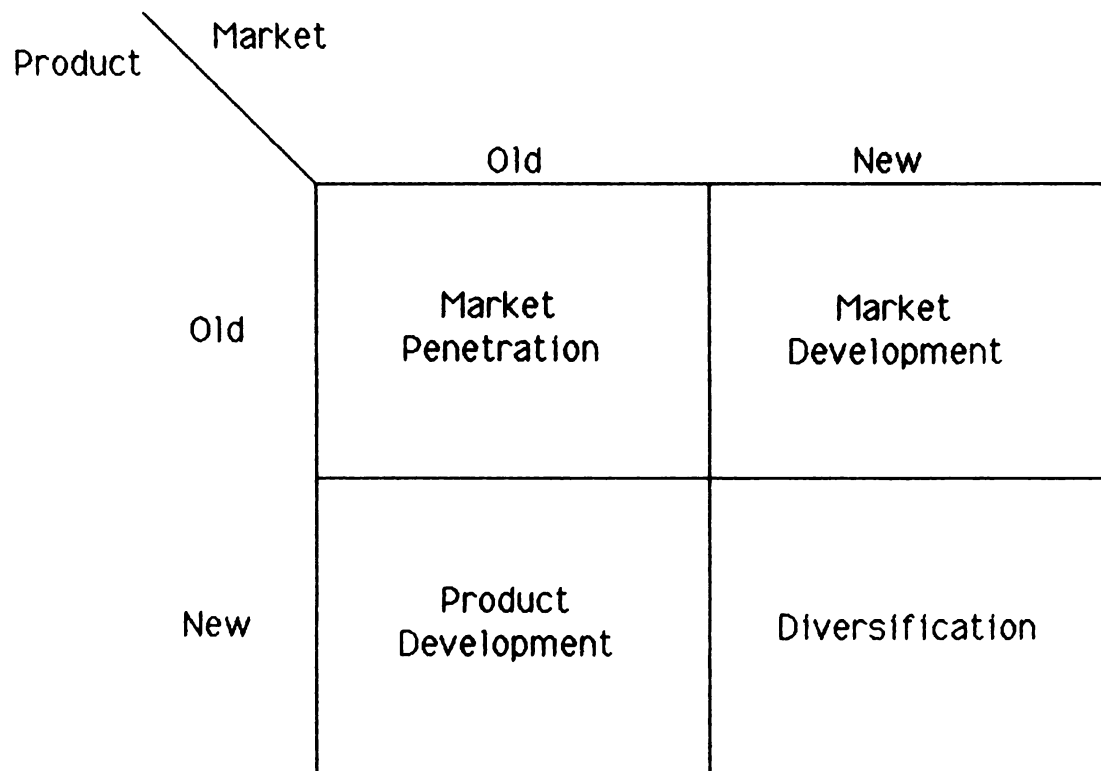


Figure 34

PRODUCT MARKET MATRIX

		Market		
Product		Old	Related	New
	Old	Market Penetration	Related Market Development	Market Development
	Related	Related Product Development	Synergistic Development	Market Diversification
	New	Product Development	Product Diversification	Diversification

Figure 35

REVISED PRODUCT MARKET MATRIX



		Market		
Product		Old	Related	New
	Old	Market Penetration	Related Market Development	Market Development
	Related	Related Market Development	Synergistic Development	Market Diversification
	New	Product Development	Product Diversification	Diversification

Figure 36

SHADED REVISED PRODUCT MARKET MATRIX

help. Further, this is another reason for trying to get the manager of the SBU to develop presence in order to maximize opportunities for the unit. A product without presence will find it much more difficult to enter related markets.

Understanding how the product and financial markets fit together can provide guidance in the interface between marketing and some of the related business areas including: production, research and development, finance, management.

In each area the relationship with marketing will be effected differently by knowledge of the interface between markets and the goal of low product market risk.

Marketing and production is a particularly important relationship. Three major areas in which production can have an impact on product market risk are: (1) product quality, (2) production capacity, and (3) product know how. For example, in the area of product quality decisions, some of the choices that may be impacted are whether the unit should milk the cow keeping cost as low as possible and perhaps sacrificing on quality in order to maximize current profits or should high quality be maintained and even higher quality sought in order to continue to attempt to improve the affective state of customers. This might be done with the realization that the SBU would be entering related product or product markets and being the standard bearer could be very helpful in gaining entry to these new markets. Quality might also be maintained with the knowledge of presence and looking at the modified BCG if the maturity phase or decline phase was anticipated as being long and a worthwhile market.

Being aware of the concept of low product market risk and the modified product market matrix would caution against making a myopic decision on

product quality that might turn out to be very short term. By lowering quality to enhance current profits a manager may be trading off very useful marketing capital for current profits; a potentially very expensive choice, considering the cost of market investment.

This study also sheds some light on production capacity decisions that should involve both the marketing and production people as well as others. The model of how product markets and financial markets relate is useful in this case. How easy is it for competition to enter the industry--what is the structure like? If too much production is coming on line and it appears that the margins are going to be small, the firm may decide not to pursue share but instead to pursue the standard designation among customers. At a minimum, it would provide a low risk environment for the introduction of related products. This might have limited profitability in the short product life cycle, but in longer product life cycles it could allow the firm to wait out the industry restructuring and end up with significant market share at a later point in time which would be very profitable. It would also provide a low risk environment for the introduction of related products. Overbuilding may be a common phenomenon in the pursuit of market share. One of the analysts gave a detailed account of how the computer industry had overbuilt capacity and how many of the firms are now in trouble. In the case of short product life cycle products, the pursuit of share may not be the answer--marketing must always be ready to be building marketing capacity for the next set of introductions. New production facilities may increase fixed costs and require more sales in what could be an overcrowded market by the time they come on line (see Figure 37).

Production impacts product market risk in the area of product know

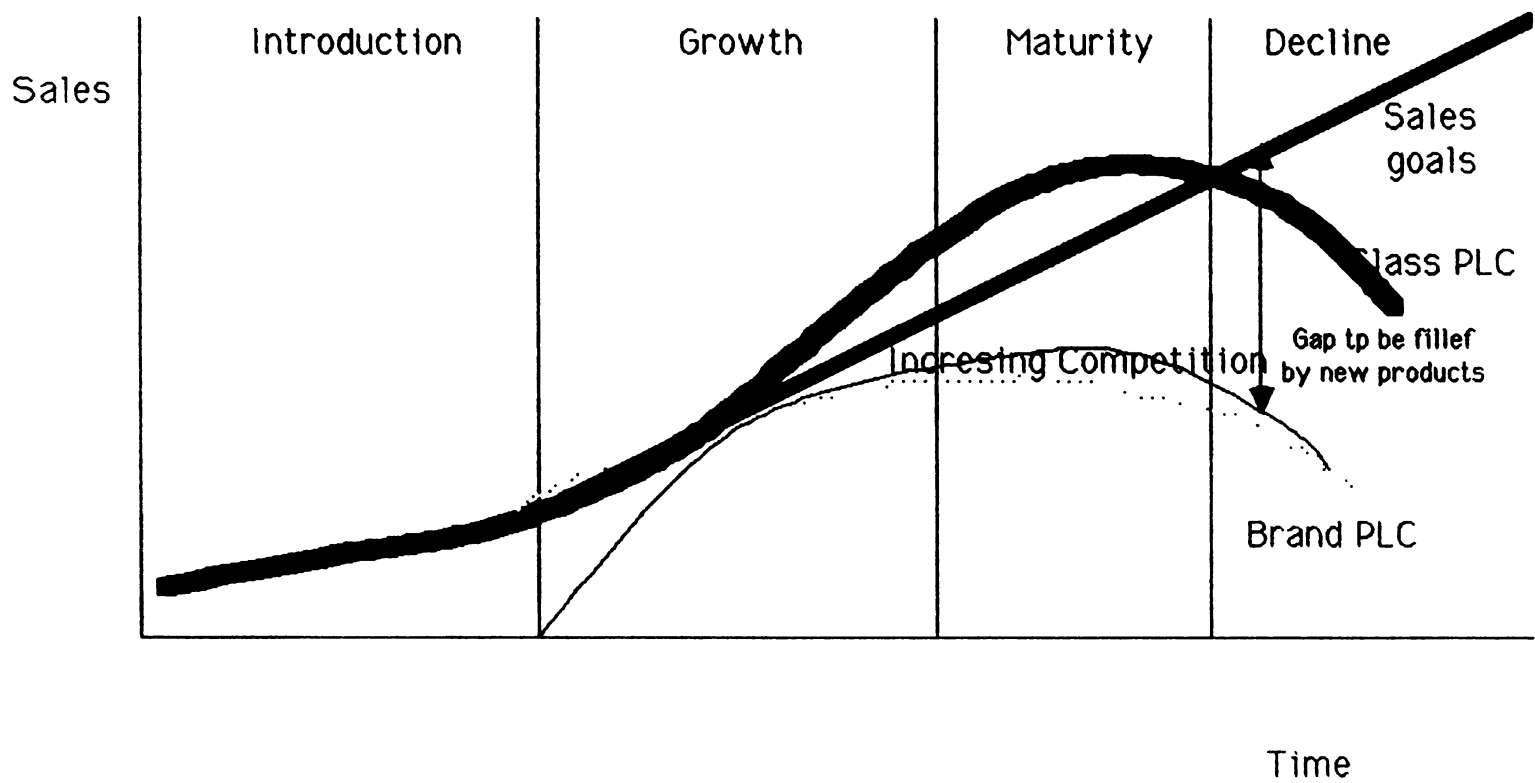
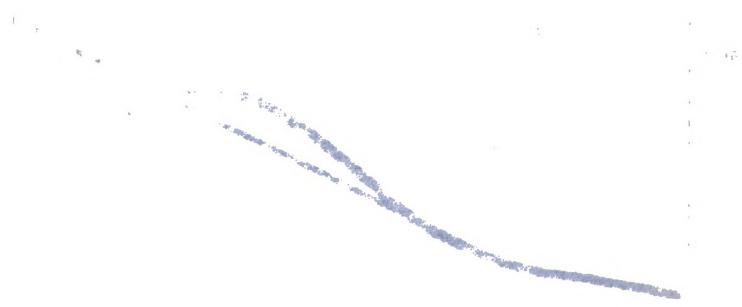


Figure 37

PRODUCT LIFE CYCLES AND SALES GOALS



Time

how. If a company is concerned about maintaining low product market risk they should be constantly seeking out ways to deliver a better product and service to the customer in the current product lines.

The interface between marketing management and the research and development area is also very important when thinking about the concept of presence and how it might impact marketing management. Three areas are: (1) direction of research, (2) amount to be invested, and (3) selection of potential products. Research and development is particularly important as it is part of marketing investment along with advertising and so forth (Clarkson).

The direction of research may be guided by the concept of product market risk and its application. Obviously it is probably best to develop those products that can enter the product market with the least possible product market risk, or product improvements that will reduce risk as well as those that will increase return. Overall, research should be directed toward products that maximize net present value, including product market risk.

The measurement of product market risk would provide help in setting performance and cost objectives.

1. Selection of influences
If the attributes and the influences that are important to customers for any given product can be discovered, then a much better job of setting performance and cost objectives can be done.
2. Changing risk levels
If the product market risk level is perceived to be changing it is necessary to determine why. Is it changing customer preference or is it changing competition? In the former case it may suffice to change marketing strategy and or price. In the latter, understanding why may be more important, particularly if the product has low product market risk. To keep the position of the product standard may require redesign to improve specifications. The

product may be moving out of evoked sets or facing increasing competition in evoked sets because of perceived changes in quality or configuration of the competition.

In the product design, the measurement of presence (perhaps of competitive or related products). provides marketing with knowledge to provide design specifications and cost parameters to be met by the new design in order to assure meeting the sales and profit projections.

Changes in presence should indicate what is being done right and should be continued, and what is being done wrong and needs correcting. Presence would give one the lead time missing in today's behaviorally based measures.

Quality improvements can reduce risk in the product market because they would not only reduce the risk for current products but also future related products. A measure of product market risk would allow managers to understand better how well they are succeeding at obtaining the market share in the cognitive and affective areas of customer minds. Research that would lead to more quality at the same or lower cost could be extremely helpful. The question again is where are the standards going.

It might also be useful in determining to what areas funds should be allocated based on the expected return. If a research product would help improve quality in a product line where another company already has presence, it may be very difficult to unseat them; another area might be selected for allocation of funds with the idea of maximizing the overall return from the product markets with the lowest possible risk. The discussion on the product market matrix, (see Figure 35) also fits in with consideration of which new products are to be pursued. Those in related markets are considered much less risky than totally new ideas. Given a

limited research budget, the marketing manager may wish to encourage research in those areas that will have the most product market significance for the firm.

Finance is an area where the importance of low product market risk on the relationship of the product and financial markets can have an obvious impact. The concept of presence can help define risk in product markets. This is essential to the long range planning of the financial officer. It may also be something that they wish to convey to the analyst and to the financial markets in an effort to bolster stock prices and lower the cost of capital to reflect the reduced risk. Financial management wishes to avoid surprises, particularly on the negative side, that will impact earnings in future quarters. They are very concerned about maintaining the general trend in earnings. There are many ways of shifting earnings around as one analyst noted (G1) These shifts are better made with an awareness of what is going on in the product markets.

The financial management is responsible, through corporate reports and through meetings (formal and informal) with analysts, for communicating information about the company to the financial markets. If marketing management can give finance some solid information about what is going on in the product markets that is likely to impact the future, they may aid in conveying to the analyst a better position of the firms real value. Many of the analysts interviewed spoke of meeting with the financial officers of the companies that they are following in an effort to learn more details.

In particular, the financial officer would like to be able to show above average growth and reduced volatility for longer periods into the future. For analysts using the dividend discount model, this could greatly impact their valuation of the firm. The typical dividend discount model has three

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2. The second part is a report on the state of the Union.

3. The third part is a report on the state of the Treasury.

4. The fourth part is a report on the state of the Navy.

5. The fifth part is a report on the state of the Army.

6. The sixth part is a report on the state of the Commerce.

7. The seventh part is a report on the state of the Education.

8. The eighth part is a report on the state of the Agriculture.

9. The ninth part is a report on the state of the Industry.

10. The tenth part is a report on the state of the Science.

11. The eleventh part is a report on the state of the Arts.

12. The twelfth part is a report on the state of the Literature.

13. The thirteenth part is a report on the state of the Music.

14. The fourteenth part is a report on the state of the Painting.

15. The fifteenth part is a report on the state of the Sculpture.

16. The sixteenth part is a report on the state of the Architecture.

17. The seventeenth part is a report on the state of the Engineering.

18. The eighteenth part is a report on the state of the Medicine.

19. The nineteenth part is a report on the state of the Law.

20. The twentieth part is a report on the state of the Religion.

21. The twenty-first part is a report on the state of the Philosophy.

22. The twenty-second part is a report on the state of the History.

23. The twenty-third part is a report on the state of the Geography.

24. The twenty-fourth part is a report on the state of the Meteorology.

25. The twenty-fifth part is a report on the state of the Botany.

26. The twenty-sixth part is a report on the state of the Zoology.

27. The twenty-seventh part is a report on the state of the Geology.

periods as follows:

First Period	Years one to five
Second Period	Years six to ten
Third Period	Years eleven to fifteen

Typically, the analyst allows the firm to have above average growth for some portion of the first period. If an analyst can be persuaded that, based on the reduced risk in the product market, the firm can expect a longer period of above average growth that would have significant impact on the value of the stock. This requires the financial officer being equipped by marketing management with facts to show why the future product market position is so strong.

Another factor that would interest the management of the company would be the idea that presence may shift the demand curve to the right or reduce the elasticity for that particular product. One of the analysts described IBM as being "sneaky, smart competitors" in that they can compete effectively with price where they need to but where the competition is weak or nonexistent they make inordinate amounts of money (P1). Pursuing presence is a market investment strategy aimed at reducing the risk side of the risk/return trade off.

Finally, financial management should be interested in the idea of presence because of the feedback to the stockmarket. Companies' products that are well thought of usually have some success at getting product buyers to become stockholders. The analyst evidenced the importance of this particularly when the product is understood by the buyers. As was mentioned earlier, one analyst mentioned that he felt that the impact of Regain (minoxidil) was overrated by buyers because they understood it and saw little risk in the product (K1) It may be possible to get product

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market buyers to be buyers in the financial markets and financial market buyers to become buyers in the product markets. If this is true then some kinds of corporate advertising may benefit both the financial markets and products markets for the firm.

Product market risk also impacts the relationship of marketing with management. A performance measure based on product market risk and the concept of presence could be a means of reconfiguring the compensations for the management of SBU's and those in marketing. Also, presence implies that there may be a longer range horizon to the marketing job of the business unit management; that might imply that these people should be compensated at a higher level, based on the idea compensation levels should be related to the length of time that into the future that peoples' decisions have impact (Jaxx).

Advertising and marketing naturally share a great deal. The concept of presence offers a way of measuring, in part, the effectiveness of the current promotional program for the business unit. It would be a measure of effectiveness in the cognitive and affective areas. The two areas that seem to impact these most are promotion and product. If the product is known to be factually better than its competitors then the job of promotion is to get the word out.

In summary, there are a number of ways in which marketing's relationship with other areas of the firm can be impacted through the use of a product market performance measure aimed at risk. This would not replace other measures but would help to add a new dimension to thinking in this area. Further the understanding of the relationship of the product markets and the financial markets would greatly improve the selection of those product market choices that can lead to the maximization of the

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shareholders wealth.

Marketing Mix and Risk

There seems to be a logical split in the way that the marketing mix impacts the cognitive and affective areas where presence is found and the sales or the behavior. This has been shown in Figure 27.

Promotion is the logical investment to achieve the cognitive levels of awareness, generic use of the name, and possibly placement, in the evoked set. The product standard for the class will have to come out of product quality itself. There are many rating services that evaluate products for consumers and general consumer protection. These services evaluate product quality and make available information on relative product quality.

A firm may have achieved presence and not have achieved much in sales. To achieve sales with presence, the marketing manager must turn to price and availability of the product. Is the product readily available and how much are consumers willing to pay for the product?

These are not, by any means, mutually exclusive ways of using the product mix. It is clear that in the case of some kinds of drive-in services such as food and gas that location may be a large part of the cognitive level. They are at least guidelines for thinking.

Presence, as has been stated, appears in the customer's cognitive and affective state. Similarly, to a large degree, presence appears in the augmented and tangible product in the model shown in Figure 38. Promotion works on the core, product on the intangible, and availability on the augmented product. Presence may also be a method by which to relate where to spend marketing dollars geographically. Using presence, it might be determined where to exploit the maximum response by mix and region.

In summary, the development of presence can help further refine the

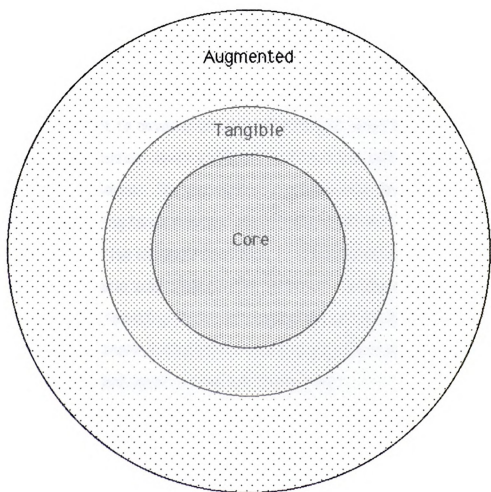


Figure 38

PRODUCT MODEL

use of the marketing mix variables as tools in reducing the product market risk as well as increasing its return.

The development of an understanding of product market risk and the concept of presence, and the model of the relationship between the financial and product markets that became an integral part of the concept, impacts much of what is done in marketing. It may provide a new framework for further exploration. It may also provide a new way to introduce students to the whole idea of the relationships of the disciplines that study business. It is often difficult to get senior students to recognize the need to be able to address the whole company and look across disciplines or even across segments of disciplines.

There has been an effort to develop an understanding of what is done in marketing at the product market level and how the flows through the firm impact the firm's shareholders. The concept of presence was developed early in the process of trying to understand the product market. It became evident that there was no risk measure available in the product market. Everything that was available was a behavioral measure. In application, there are many companies focusing on the elements that are within the scope of presence through market research; in particular, the intense use of focus groups to understand what customers think about.

It is hoped that the concept of presence and that the related modification of models that have been developed will stimulate others to further explore this same area in order to define better the current marketing performance and to provide better tools for projecting the future.

Formalization of Model

It would be ideal if the model (figure 28) could show strengths of inter-relationships factors and the way that analysts evaluate. As explained in the development, each factor could be interpreted to have varying strengths and positive or negative influences, depending on the scenario and the interpreter. It is believed that the model itself has relatively fixed relationships; however, what is subject to change is the perception of the beholder of the model. Since this study was limited to one group, financial analysts, it is felt more work needs to be done to fully develop the model.

There are a number of considerations that impact the perceived strength and direction of influence, including the level of risk averseness and awareness of investors and the particular choices facing management. In the present case analysts are used as a surrogate for investors.

Figure 28 displays the relative strengths of the various influences that impact analysts' valuation of publicly held firms. From the strongest to the weakest they are: (1) financial market performance, (2) corporate financial performance, (3) product market performance of the SBU, (4) customer behavior, and (5) customer, cognitive and affective.

Further studies could explore whether the same order would be perceived by the ownership of privately held firms. A privately held firm might have reduced concerns with financial market evaluation and have a much greater weight on product market risk as the owners ability to diversify risk with the traditional portfolio of securities is often limited. A study of privately controlled firms might show a greater interest in future performance. Therefore, the perceived importance of different areas of the model could be inverse to those above: (1) customer cognitive

and affective, (2) customer behavior, (3) product market performance of the SBU, (4) corporate financial performance, and (5) financial market performance.

Venture capitalists and bankers making longer term commitments may have different sets of interest and priorities focusing on the S.B.U. and corporate performance. These should also be investigated to further develop the model and understand how its factors are perceived and used in different sets of circumstances.. A bank, for example, could be more concerned with the current ability to service the debt (corporate performance) and less concerned with product market risk and financial market performance. Venture capitalists might have a longer term horizon and view different strengths depending on their objectives.

For each individual, the situation would determine the perceived impact of each factor in each area of the model, positive or negative, and the strength of that influence. The model's major contribution may be to lay out factors that influence the relationship of the product markets to financial markets, in particular the area of product market risk.

Further study may allow the finalization of the model's factors. It is conceivable that a different group could point out to a researcher additional areas for consideration. The next level might be to explore perceived directions of influence under given sets of conditions. Thus, given assumptions such as earnings focus, primarily held by institutions using models, it may be possible to assign strength and direction to all factors. This would require further study. However, to provide an example, an attempt has been made to assign to the model influences and levels of strength (actual number of respondents) from the content analysis. This example was developed assuming that the analysts were

and effective. The SBU (SBUs) have different performance.

venture-capital, which is different from the corporate performance.

the first stage of the venture capital process is the selection of the venture capital fund. The venture capital fund is a pool of money that is used to invest in start-up companies. The venture capital fund is typically managed by a venture capitalist, who is responsible for selecting the companies to invest in and for monitoring their performance. The venture capital fund is typically structured as a limited partnership, with the venture capitalist as the general partner and the investors as limited partners.

the second stage of the venture capital process is the selection of the companies to invest in. The venture capitalist typically selects companies that are in the early stages of development and that have a high potential for growth. The venture capitalist typically selects companies that are in the early stages of development and that have a high potential for growth. The venture capitalist typically selects companies that are in the early stages of development and that have a high potential for growth.

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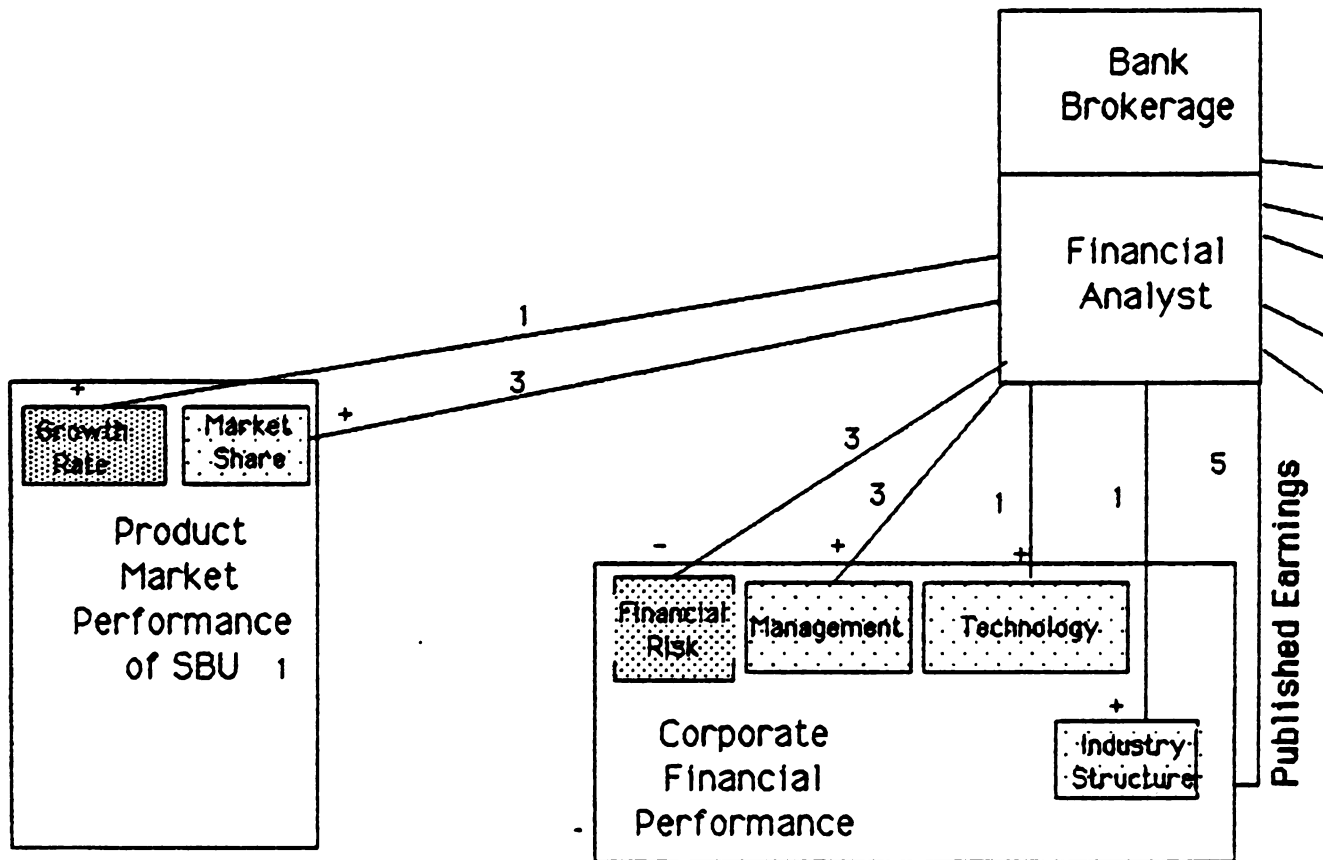
the fourth stage of the venture capital process is the selection of the companies to invest in. The venture capitalist typically selects companies that are in the early stages of development and that have a high potential for growth. The venture capitalist typically selects companies that are in the early stages of development and that have a high potential for growth. The venture capitalist typically selects companies that are in the early stages of development and that have a high potential for growth.

model users, dividend growth or low p/e, and the shareholders were primarily institutional investors.. The strength is indicated by the raw score of model users who mentioned a factor. The positive and negative direction of influence were assigned by the author as was the strength in each scenario as indicated by shading. There were five model users.

These are very subjective evaluations. The comparison of the perceived strength and direction of the dividend discount model users, Figure 39, with the nine analysts in decentralized firms, Figure 40, should provide an indication of how the perception of the model changes under different scenarios. Reviewing the model and the factors in detail starting with the model users are in Figure 39.

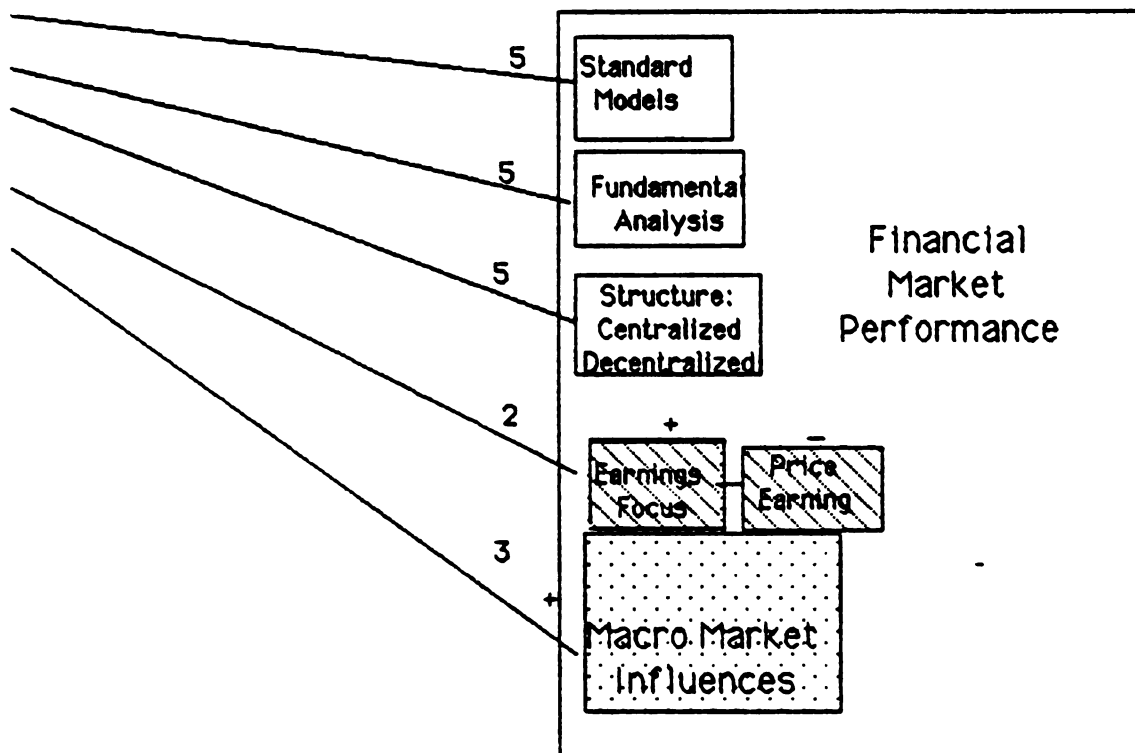
A. Financial Market Performance

1. Macro Market Influences (2/5)
 - a. Macro market influences would impact the dividend growth model, particularly in the calculation of the discount rate.
 - b. Macro markets would have little influence on presence or product market risk.
2. Valuation
 - a. Earnings focus and Price Earnings (2/5) are both of interest to those analysts using the price/earnings ratio. While they might not appear to be related to presence or product market risk, it is quite possible that one of the reasons that the low p/e strategy is successful is because of an inaccurate reading of risk in the product markets.
 - b. Standard models, fundamental analysis, and structure, (4/5) would be important under this scenario. As the use of models is increased it should lead to a greater dependence on published information which precludes a direct look at the product market risk or presence.
3. Published earnings (5/5) are extremely important in the models as the earnings are generally looked at closely in the calculations. Published earnings by definition do not reflect the impact of carry over in presence or product market risk.



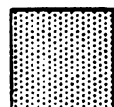
Model Users

Figure 39

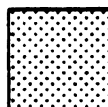


Price Earnings Only

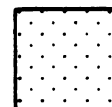
+ or- Direction of influence assigned by author
 Numbers are raw score from content analysis
 Shading is perceived strength assigned by author



High



Medium



Low

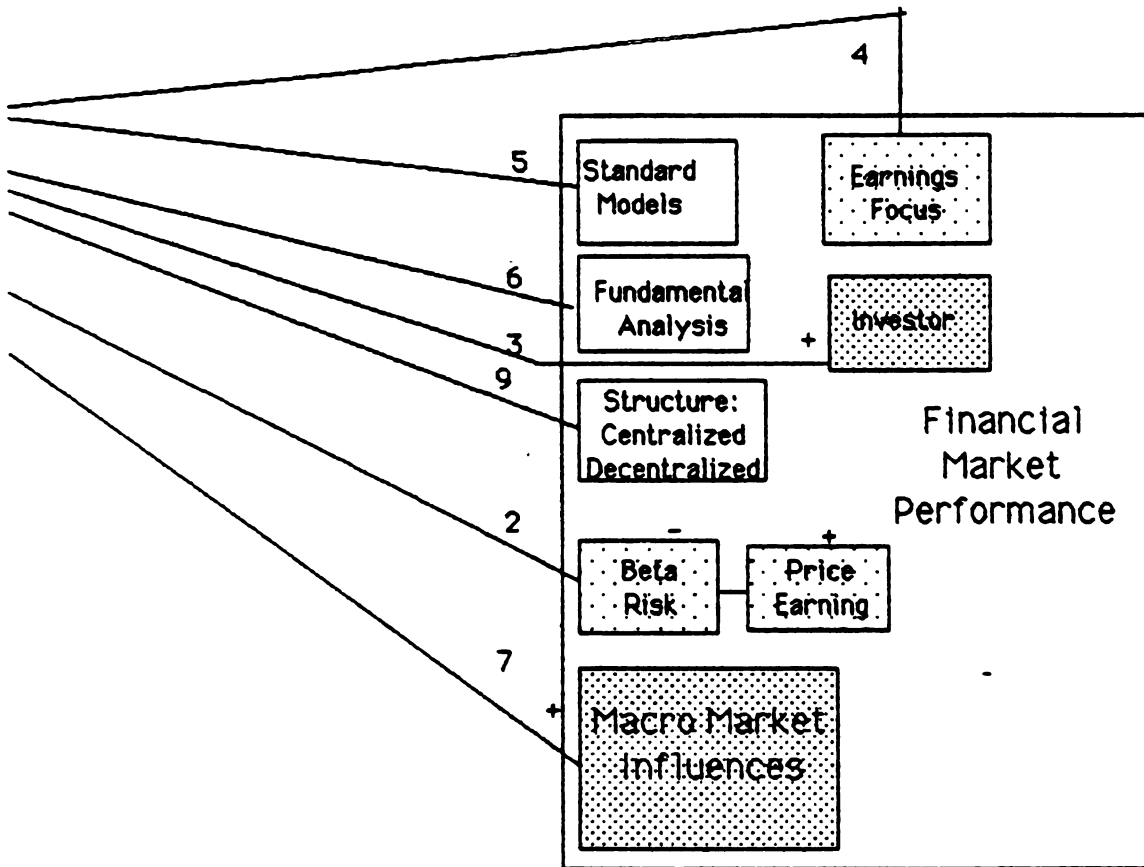
Model Users

Figure 39 cont'd

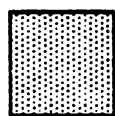
- B. Corporate Financial Performance
While all areas of corporate performance contribute to published earnings, the ones that appear to be most important to the model users are financial risk (3/5), management (4/5) and technology (1/5). The factors of management, technology, and industry risk may be indicative of an interest in some product market related information and the kinds of risk that may be faced, or the carry-over that may be expected.
- C. Product Market Performance of S.B.U.
The most important of the S.B.U. factors that impact the model users are: growth rate (1/5) and market share (2/5). In this area there is not a direct look at any of the future factors but that may be because analysts who use models have not been provided the structure to do so in any of the models.

In contrast the model is perceived differently under the scenario of analysts who work for decentralized firms (Figure 40), three of whom did do some product market research. Starting again with Financial Market Performance:

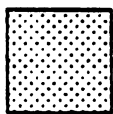
- A. Financial Market Performance
 - 1. Macro Market Influences (7/9)
Market psychology and rumor is a dominant influence affecting the price of the security. These may be based on any number of factors, but clearly can include information of product market risk or ideas related to presence.
 - 2. Investors (3/9)
The type of shareholders would be very important to the subjective evaluation. The more shares held by institutions the more short-term holding horizons the analyst must assume. The longer term holdings may allow analysts to think further into the future and be more concerned with ideas like presence.
 - 3. Valuation
 - a. Earnings focus (4/9). This can be important in a subjective evaluation. Many still have a dependence on current earnings.
 - b. Standard models (6/9), were used as checks by many who used subjective evaluation methods.
 - c. Fundamental analysis (6/9) is expected among those doing a subjective evaluation.
 - d. Decentralized (9/9) was one of the selection criteria.



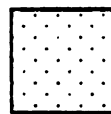
+ or- Direction of influence assigned by author
 Numbers are raw score from content analysis
 Shading is perceived strength assigned by author



High



Medium



Low

Analysts From Decentralized Firms



- e. Price earnings and beta risks (2/9) are reflective of using models as checks.
- 4. Published Earnings (7/9)
Published earnings are important under a decentralization method of valuation. The more published information available, the better it can be reflected in the analyst's valuation.
- B. Corporate Financial Performance and Product Market Performance.
Most of these factors are important and are looked at by the analysts in a subjective way. The difficulty with subjective evaluation is it is hard to point to relationships.
 - 1. Management (9/9) is extremely important in the subjective evaluation process and may also be a method of looking at product markets.
 - 2. Technology (5/9) is important as an assessment in the subjective evaluation and may be away of looking at some product market issues.
 - 3. GAAP (6/9), is used more than the model users as those using the subjective approach may be looking behind the statements.
 - 4. Financial risk (2/9).
- C. Product Market Performance of Strategic Business Unit (4/9)
Analysts in the subjective area cited a number of different factors that they looked at in the product markets. This is not surprising as everyone is looking for their own method to find a defensible, non-consensus position.
 - 1. Industry Structure (4/9)
 - 2. Market Share (7/9)
 - 3. Growth Rate (3/9)
 - 4. Product Market Risk (4/9)
There is interest among analysts in product market risk under this scenario which did not show up directly amongst the model users.

The differences in the subjectively evaluated figures are significant as the two extremes were from the analysts interviews. The model's major contribution may be to raise the issue of what factors are perceived and considered in attempting to understand the relationship of product market risk and its impact on the valuation of securities.

It is expected that longer term involvements, such as privately controlled, privately owned, venture capitalists and banks, would have more interests in areas closer to product markets and therefore product

market risk and presence. This hypothesis needs to be tested. At the same time there should be an exploration into new components of the model that may not have been brought out by the use of financial analysts alone.

Future studies may also wish to examine individual factors or clusters that impact specific areas, such as corporate performance, or the product market performance of an S.B.U. For example: Does market investment have a negative impact on capital performance as reported? or, Does management attempt to communicate product market risk information to the financial community? Further research into the specific research questions will be discussed below.

Future Directions

The focus of this paper has been to understand product market risk, in particular, low product market risk as represented by presence. Product market risk is an area that has not received much coverage in the marketing literature. Instead, the focus has been on return. Understanding product market risk and developing measures of it would allow marketing to learn more from economic analysis, in particular the extensive work on risk and return that has been done in the finance area. Considering the macro economic model introduced into chapter one, it is time that the product markets be considered in the same way that the resource markets are: using both risk and return.

On a micro economic level, looking at the corporation, the concept of product market opens up some new choices for management. Once it is understood that the maximization of shareholder wealth can be influenced by both risk and return, for example, raising return and holding risk constant or lowering risk and holding return constant, then management

can begin to explore the trade-offs available in resource allocation between risky investments. This paper is not suggesting that the whole focus should be on risk, but rather that strategies should be considered in light of how they might effect product market risk. The quantification of the uncertainty in the product markets into risk would allow management to make more sophisticated choices when considering investments for the future.

Theoreticians may continue to explore the areas of product market risk and the concept of presence to integrate the product markets more fully with the responses in the financial markets given the approach that both markets are concerned with risk and return. This may allow marketers to integrate more closely micro marketing with the macro marketing models.

Research Questions

Considering the research questions proposed in chapter one it appears that a start has been made at understanding these areas but there is more research to be done for a fuller understanding. The first question regarding the relationship of stockholder objectives and the firm's objectives, has been laid out in chapters two and three in the review of marketing and finance literature. In chapter six there has been a further explanation of why the ideal of linking these together is difficult. The large amount of publicly traded stock in the hands of institutions and the sophisticated level of financial markets leads to a much shorter term view of creation of shareholder wealth. It is proposed that a similar study be conducted among large privately controlled firms to determine how those shareholders look at product market risk. A related area of research would be to look at firms where a significant block of stock is held by

management. Also, the area of how product market risk and return trade-offs are made under different management compensation plans could be explored. There may be room for a product market risk performance measure. It is clear that currently analysts and therefore the financial community do not have the tools to do much with product market risk. Marketing should accept the challenge to develop this area before the investment community explores it as a practical matter.

The second question on the relationship between the product market risk and the financial markets is closely related to the first. Again, the investment community apparently has only begun to explore this area, but it is an area in which marketing might be able to be extremely helpful in both the development of theory and application. There are several areas to be explored including: What is the impact of different types of shareholders on product market risk? Is there a difference between employee stock option plans and other forms of ownership? What kind of product market risk measure would be most useful? What kind would be most exact? How could product market risk and the related concept of presence fit into the current stock evaluation methods on a more objective basis than it is currently being handled? Is there some way to help analysts to see clearly what is going on in the product markets in terms of risk and is that desirable?

The third question asks, what are the needs for a marketing based product market risk measure? It is clear that if analysts had a measure it would be theoretically useful. What would be needed to make it useful in application? Is it possible to develop a measure that could be easily calculated and revised? This would be relevant both in the financial markets and in the area of marketing management. This discussion has

focused on quantifying uncertainty: are there ways of doing that, such as Beta, that may be far from perfect as a forward measure but does offer some distinct insight? The study revealed that analysts tend to focus on easily available measures from corporate releases; could a product market risk measure be included?

Finally, the question was asked if valuations could be fully explained from traditional measures. It appeared that the answer was "no," since the analysts are always looking for new information that may allow them to gain insight and take a non-consensus position. There is much subjectivity in what they do. For about half the analysts interviewed, the traditional measures are being used as checks. Could an understanding of product market risk improve the explanatory power of extant measures?

Conclusion

This has been an initial exploratory study to raise the issue of product market risk. There has been an attempt to explore what the state of low product market risk or presence might mean in both theoretical and applied areas. There is room for a great deal more exploration. If a measure of a firm's presence could be developed using, perhaps, the suggested elements or additional elements that future investigators may see as relevant, it would advance the discipline substantially. Given such a measure, it would be possible to investigate the impact of presence on the cost of capital. The differing of the use of the product market risk concept by different types of analysts and portfolio measures could be studied.

Product market risk is an area deserving much more exploration for marketers. Additionally, there is a substantial amount of work to be done

in considering the trade-offs to be made between risk and return in product markets. Marketers are fortunate that there is a large body of work in finance and economics to draw on if product market uncertainty can begin to be quantified into product market risk.



APPENDIX A-1
INDIVIDUAL CONTENT ANALYSIS MASTERS

J2

- | | | |
|-----|----------------------|---|
| 4. | D9, D7, D5, D8c, D1 | |
| 5. | E2 | "Longer Term" |
| 6. | F1
F2 | Long-term families
Short-term for institutional holdings |
| 7. | G2c
G2e | Earnings power
"Importance of Macro Forecast" |
| 8. | H1, H2, H9, H8a, H5d | "How long a situation can be maintained" |
| 9. | I3a | |
| 10. | J1b | Nielsen, <u>WSJ</u> |
| 11. | K2 | Forecast Market Share |
| 12. | | |
| 13. | M1b | <u>WSJ</u> |
| 14. | N/A | |
| 15. | O1, O4 | Growth rate, product orientation |
| 16. | N/Q | |
| 17. | Q6 | |

APPENDIX A-1
INDIVIDUAL CONTENT ANALYSIS MASTERS

M1

- | | | |
|-----|-------------|--------------------------|
| 4. | D1, D4, D5 | Earnings Estimate change |
| 5. | E2 | Delay rate |
| 6. | F2 | 1/3 turnover |
| 7. | G2b | Multifactor Model |
| 8. | H1, H2, H4a | Barr Rosenberg |
| 9. | N/A | |
| 10. | J1 | |
| 11. | K1 | Delay rates |
| 12. | N/A | |
| 13. | M3 | |
| 14. | N1 | |
| 15. | | |
| 16. | N/A | |
| 17. | N/A | |



APPENDIX A-1
INDIVIDUAL CONTENT ANALYSIS MASTER

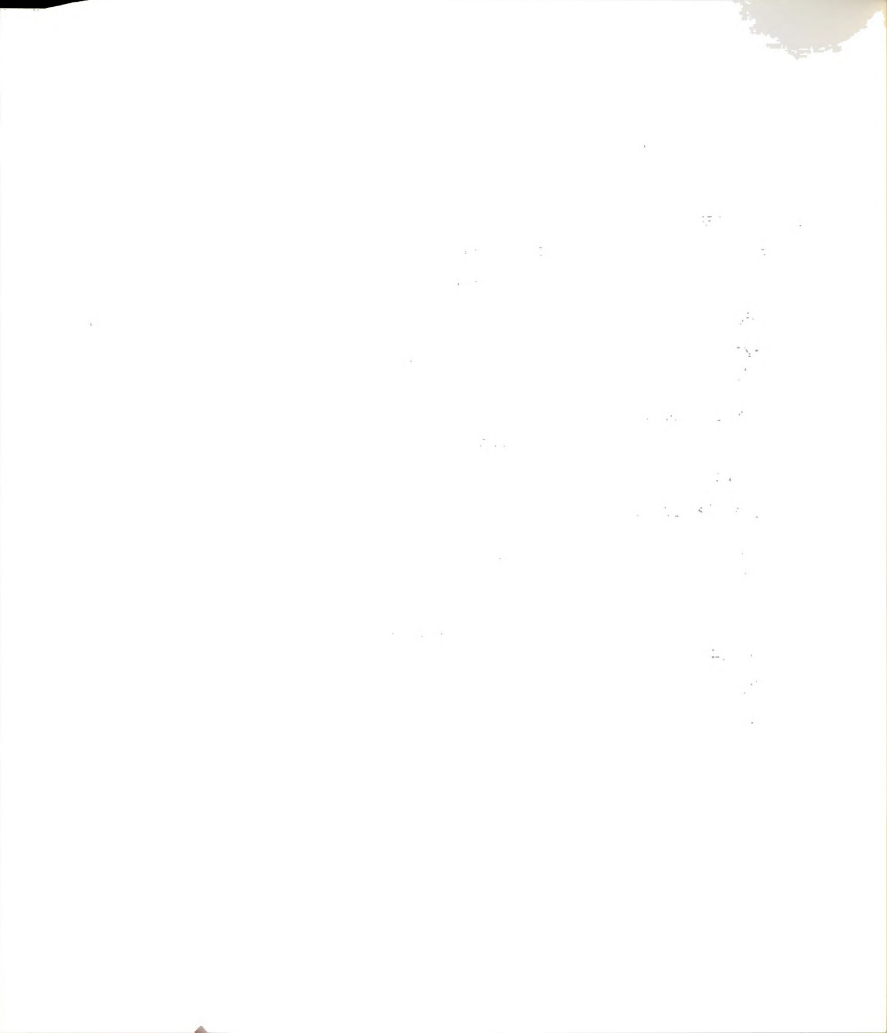
A1

- | | | |
|-----|------------------------------|---|
| 4. | D1
D6
D3 | Company, Industry
"Getting to know company" |
| 5. | N/Q | |
| 6. | N/A | |
| 7. | G2e | Models used to value parts of the transaction |
| 8. | H1
H2b
H4a
H5e, H5d | Volatility
Business Cycles |
| 9. | I1b | Very subjective; but, a plus |
| 10. | N/Q | |
| 11. | K1, K2 | |
| 12. | N/Q | |
| 13. | N/Q | |
| 14. | N/Q | |
| 15. | O4
O1 | Change in Product Environment
Management stay on |
| 16. | N/Q | |
| 17. | N/Q | Capitalizing customer lists |
| 18. | N/Q | |

APPENDIX A-1
INDIVIDUAL CONTENT ANALYSIS MASTER

G1

- | | | |
|-----|--------------------|------------------------|
| 4. | D6B, D5B | Numerical Ratings |
| 5. | E1 | Point of departure |
| 6. | F1 | Held for grandchildren |
| 7. | G6c | |
| 8. | H2a
H4
H7a | Evaluating company |
| 9. | I2a, I2b, I3b, I3c | |
| 10. | J2b | Yankee Group |
| 11. | K1, K2 | |
| 12. | L1a, L2a, L2b, L2d | |
| 13. | M1
M5
M6f | Gartner Group |
| 14. | N1 | |
| 15. | O1
O2, O4 | For small companies |
| 16. | P6 | No |
| 17. | Q1 | |



APPENDIX A-1
INDIVIDUAL CONTENT ANALYSIS MASTER

K1

- | | | |
|-----|----------------------------|---|
| 4. | D1
D6 | R & D emphasis management |
| 5. | E1 | One day or less |
| 6. | F2 | |
| 7. | | |
| 8. | H1, H5e
H3
H4c
H9 | Leverage risk
Currency risk
Regulatory risk |
| 9. | I1e
I3c, I2b | Research |
| 10. | J1a | IMS |
| 11. | K1, K2 | |
| 12. | N/A | New Prescription Trend |
| 13. | M1, M4d
M5 | Prescription trends |
| 14. | N1 | |
| 15. | O1, O4, O2 | |
| 16. | N/Q | |
| 17. | N/Q | |

APPENDIX A-1
INDIVIDUAL CONTENT ANALYSIS MASTER

L1

4. D1, D9

5. E2 Product horizons

6. N/Q

7. G2e Economic cycles

8. H1
H4a
H5a
H5e, H5g, H7a, H8a, H10

Downturns, lags, overspending
Triangulate supply and demand

9. I1d
I1a, I3

IBM

10. J2

11. K2

12.

13. M2
M4, M5, M6c, M6d

Business function

14. N/A

15. 02, 03, 04

1914

1915

1916

1917

1918

1919

1920

1921

1922

1923

1924

1925

1926

1927

1928

1929

1930

1931

1932

1933

1934

1935

1936

1937

1938

1939

1940

APPENDIX A-1
INDIVIDUAL CONTENT ANALYSIS MASTER

M2

7.	G2b G1a	P/E Model
8.	H1	Deviation % critical
9.	I4b I1b	Substitutes, foreign
10.	J1	Occasionally
11.	K2	
12.	N/A	
13.	N/Q	
14.	N/A	
15.	O4	Historical earnings Order backlog, secular growth

APPENDIX A-1
INDIVIDUAL CONTENT ANALYSIS MASTERS

H1

- | | | |
|-----|--------------------------|---|
| 4. | D1, D3, D8c, D2, D7, 09 | Valuators, different perceptions than other analysts. |
| 5. | E1 | 6 to 12 months |
| 6. | F2 | Technology stocks very short term |
| 7. | G2b, G2a, G1a, G1c | A check, asset valuation, first five years in dividend growth most significant |
| 8. | H1, H7, H8, H10, H2a, H4 | PLC key aspect to company specific risk. Flow of new products important, product transition risks are key |
| 9. | I1 | Product announcements (IBM) |
| 10. | J1, J2 | |
| 11. | K1 | Forecast based on historical interpretations |
| 12. | L1, L2d | Long-term for small companies |
| 13. | M1a, M3, M4b, M4c, M4d | |
| 14. | N1 | |
| 15. | O1, O2, O3, O4 | Follows newsletters and reports |
| 16. | P3 | Relative Multiples - earnings up up |
| 17. | Q6, Q5 | Won't buy stock, CEO should do what makes sense strategically unless need financing |

18.

InstituteIndividual

IBM
CRAY
DEC

CRAY
IBM
DEC

APPENDIX A-1
INDIVIDUAL CONTENT ANALYSIS MASTERS

G3

- | | | |
|-----|------------------|--|
| 4. | D5, D6, D9, D1 | Follow top 50, analyze franchise, cash flow, asset value, industry structure |
| 5. | | |
| 6. | F1 | |
| 7. | | Asset valuation, cash flow, multiple |
| 8. | H4, H1, H5d, H8a | Cash flows, franchises, stability, cost benefit |
| 9. | I1, I1c, I2d | |
| 10. | J1a, J1b | Circulation, Advertising, lineage |
| 11. | K2, K1 | Pretty stable cash flows |
| 12. | N/A | Demographics |
| 13. | M3 | Readership demographics, Nielsen |
| 14. | N1 | |
| 15. | O1, O3 | |
| 16. | P3 | |
| 17. | Q1 | Impacts stock price |
| 18. | | New York Times, Tribune, Affiliate publications |

APPENDIX A-1
INDIVIDUAL CONTENT ANALYSIS MASTER

D2

- | | | |
|-----|----------------------|---|
| 4. | D5, D3, D1, D8 | Leading Market position, constant future earnings growth, ROE, Solid Management, Committee Basis |
| 5. | G2 | |
| 6. | | Constantly re-assessed, hold as long as unique |
| 7. | G1a | Dividend Growth Model |
| 8. | H1, H8, H2a, H9, H59 | Volatility, Beta is price driven
Rosenberg Beta, Little Level Risk
P/E Focus, Risk of Overpricing |
| 9. | I2, I3 | Not much industry information available in spec. sit., looking for superior relative, pure plays, subsets, niches |
| 10. | | Informal |
| 11. | K1, K2 | Heavy historical emphasis, niches |
| 12. | | Long Term |
| 13. | N0 | |
| 14. | N1 | When available |
| 15. | O1 | Tech. difficult to assess |
| 16. | P1 | Institution of Market, Earnings short-term to market |
| 17. | Q6 | Short Term, Firms are hesitant to invest |
| 18. | | Symbolics
Isometrics
Toys R Us |

APPENDIX A-1
INDIVIDUAL CONTENT ANALYSIS MASTER

P1

4. D1, D2

5. E1

6. F3

Same for 10 years

7.

Little weight on models, subjective,
order oriented

8. H10, H7, H5

Primary research into product market
acceptance

9. I4, I2b

Margin Improvements

10. J2a

11.

Does not use historical measures -
misleading

12.

Trends, growth by product line

13. M2, M4, M5, M6, M6c, M6f

14. N1

15. O2, O3

O3 by firm

16. P3

No GAAP - does not influence

17. Q1

An issue, but work with FASB

18. R1

Institution

Individual

IBM
ALTOS
DEC

IBM
ALTOS
DEC

APPENDIX A-1
INDIVIDUAL CONTENT ANALYSIS MASTER

G2

4. D1, D2, D6, D8, D7

5. E5, E7, E1

6. F1, F2

7. NO

8. H1, H5, H7, H10, H9

9. I3

10. J2a Wanders through shopping center

11. NO

12.

13. NO

14. N1

15. 02, 04, 03, 01

16. P1

17. Q6 Yes

18. Institutional Industry

Sterling	Sterling
Warner Lambert	Warner Lambert
J & J	J & J
	Lilly



APPENDIX A-1
INDIVIDUAL CONTENT ANALYSIS MASTER

F1

4.	D1, D3, D9, D6, D8	Subjective
5.	E1, E5	Three year focus
6.	F3	
7.	G1	Technical analysis, curiosity value, benchmark
8.	H1, H2b, H3c, H4, H5d	Little product risk, level is good
9.	I1b, I2c, I3	Economic franchise, cash management, specialty magazines
10.	J1, J2a	Profits and revenues of magazine advert. Computer Model Nielsens to sales ratio
11.	K1, K2	Household penetration, Demographics
12.	L1d	3-5 normalize earnings vs. cyclical
13.	M2, M4, M5, M1b	
14.	N1	
15.	O1, O2, O4	
16.	P1, P3, P4	Problems with computers
17.	Q5	Earnings and risk, good economic risk S/B taken
18.	<u>Institute</u>	<u>Individual</u>
	Gannett	Times Mirror
	D & B	Knight Ridder
	Cap Cit	NY Times

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APPENDIX A-1
INDIVIDUAL CONTENT ANALYSIS MASTER

B1

- | | | |
|-----|------------------------|---|
| 4. | D6 | Stocks not widely followed, seat of the pants balance sheet approach |
| 5. | E2 | |
| 6. | | |
| 7. | G1c | |
| 8. | H7b, H5g, H1, H7b, H7d | Asset valuation, market segments, distribution network Beta available |
| 9. | I1d, I2 | Product substitutes |
| 10. | J1d | |
| 11. | K2, K1 | Support intuition |
| 12. | N/A | |
| 13. | M1c | Would like to do more product market research, Trade Journals |
| 14. | N1 | |
| 15. | O1 | |
| 16. | N/Q | |
| 17. | N/Q | |
| 18. | N/Q | |

APPENDIX A-1
INDIVIDUAL CONTENT ANALYSIS MASTER

N1

- | | | |
|-----|-------------------------------|--|
| 4. | D6, D1, D7 | Decay of growth rates, look for troughs
Momentum of sales and earnings
Bottom up by product line |
| 5. | E1, E5 | 18 months |
| 6. | F2, F3 | Depends upon client |
| 7. | G2e | Very weak on models |
| 8. | H7b, H2a, H5e, H1a
H5d, H8 | Management first, basically buying
people, volume, Technical Delphi,
Depends on client |
| 9. | I3, I2c, I1d, I4b | Structural change, I1d American
Hospital Supply, Cost structured,
changing rapidly |
| 10. | J1a, J2b, J1b | Delphi Medical Advisors
IMS, Own studies by exception |
| 11. | K2, K1 | Historical models, P.L.C., Market Share
Everything |
| 12. | L1d | No real difference, telephone surveys |
| 13. | M1, M2, M4, M5, M6b | Consultants, Delphi, Panels, telephone
surveys |
| 14. | N1 | |
| 15. | O1, O2, O4 | |
| 16. | P1 | Dependent on life cycle |
| 17. | Q6 | Structural changes are affected |
| 18. | | Lilly, Biomet, Al Labs |

APPENDIX A-1
INDIVIDUAL CONTENT ANALYSIS MASTER

C1

- | | | |
|-----|--------------------|--|
| 4. | D5, D4, D1, D9 | Low P/E model, Proprietors Model, run once a month, Strong P/E focus |
| 5. | E2 | |
| 6. | | Re-evaluated monthly |
| 7. | G2b, G2c, G2d, G1a | Five year Treasury Standard |
| 8. | H1, H2a | Very low betas |
| 9. | I2 | ROI, Marketshare, indirect, fundamental analysis |
| 10. | J/C | Model freezes on direct product market information |
| 11. | | Market share implicit in Dividend growth model |
| 12. | | Short Term Focus |
| 13. | M3 | Visit with analysts regularly |
| 14. | N1 | Part of fundamental analysis |
| 15. | | Secondary opinion management |
| 16. | NQ | |
| 17. | NQ | |

APPENDIX A-1
INDIVIDUAL CONTENT ANALYSIS MASTER

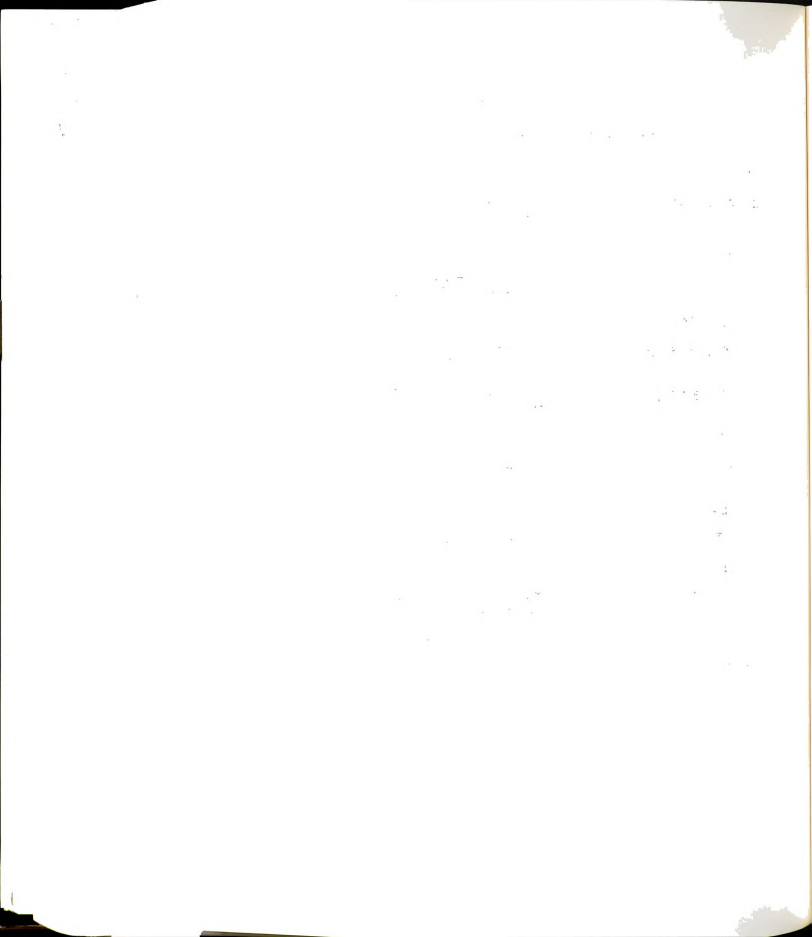
E2

- | | | |
|-----|------------------------|---|
| 4. | D1, D4, D5, D9 | Approved Stock List, look for under-valuation, Dividend Discount Growth Model |
| 5. | E3, E5 | 15 year, Three State Dividend Discount Growth Model |
| 6. | F2 | Hold as long as undervalued |
| 7. | G1a, G1d, G2b | Models other than First Chicago Div. Discount are used for check |
| 8. | H1, H2, H5d, H5f, H10c | Betas adjusted if products are slipping |
| 9. | I4 | Product line, cash needs |
| 10. | | |
| 11. | K2 | Fair price in current market |
| 12. | | |
| 13. | M2, M6 | |
| 14. | N1 | |
| 15. | O1, O3 | Management very important |
| 16. | N/Q | |
| 17. | Q5 | Evaluates mkt as an investment return/
mkt costs |
| 18. | N/Q | |

APPENDIX A-1
INDIVIDUAL CONTENT ANALYSIS MASTER

D1

- | | | |
|-----|-------------------|--|
| 4. | D9, D1, D6 | ROE, Primary List; 15% anticipated return |
| 5. | E2 | |
| 6. | F3 | Conservative 10-15% per year
Aggressive 50% per year |
| 7. | G2e, G1c | |
| 8. | H5g, H1, H8, H5a | Unit growth, dominant marketshare, growth rate, Future oriented trends |
| 9. | I3, I1a, K1d, I2a | Compare to others in the industry - not the industry as whole |
| 10. | J1 | Sellside reports |
| 11. | K2 | Subjective comparison to industry surrogate |
| 12. | N/A | |
| 13. | M3 | Management seminars |
| 14. | N1 | |
| 15. | O1, O3 | Technology, a function management, attend seminars |
| 17. | Q1 | No market efficient |
| 18. | N/Q | |



APPENDIX A-1
INDIVIDUAL CONTENT ANALYSIS MASTER

H2

- | | | |
|-----|--------------------|--|
| 4. | D1, D3, D8, D5, D6 | Franchise companies, predictable cash flows |
| 5. | E1 | |
| 6. | F2 | Not many surprises with franchises, occasionally longer than 2 years |
| 7. | G2b, G2a, G3 | |
| 8. | H1, H2, H4, H5d | |
| 9. | I1, I2 | Industry structure, monopoly or oligopoly, franchise |
| 10. | J1b | Nielsen's |
| 11. | | |
| 12. | L3 | |
| 13. | M1 | Nielsen's (MI) |
| 14. | N1 | |
| 15. | O1, O3 | |
| 16. | P3 | Goodwill amortization |
| 17. | Q1 | |
| 18. | R1a | Southard |

Institutional

NYT
Wash. Post
D & B

Individual

Gannett
D & B
NYT

APPENDIX A-1
INDIVIDUAL CONTENT ANALYSIS MASTER

J1

- | | | |
|-----|-------------------------|--|
| 4. | D4, D9, D1 | Dividend growth |
| 5. | E2 | Long term characteristics are primary determinants of value, discount to infinity |
| 6. | N/A | |
| 7. | G2b, G1a, G1c, G1d, G3a | |
| 8. | H1, H5g, H2a, H8a | Market Share, Market growth; Purchased Beta cost benefits overlooked |
| 9. | I2a | Lack of hard information, growth rate and dividend growth rate |
| 10. | J1c | Sellside analyst strongest aspects of Wall Street Research |
| 11. | K1 | Forecasted Beta purchased |
| 12. | | Long term determines value of stock
Short term current operating statement |
| 13. | M3 | Strongest aspect of Wall Street Research
Industry information and some consumer information |
| 14. | N1 | |
| 15. | O1 | Technology not as important, O1 small companies |
| 16. | N/A | |
| 17. | | How do you quantify? Difficult |
| 18. | | |

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2. The second section focuses on the role of technology in modern business management. It highlights how digital tools and software can streamline processes, reduce errors, and improve overall efficiency. The author argues that embracing technology is not just a luxury but a necessity for staying competitive in today's fast-paced market. Examples of various software solutions and their benefits are provided to illustrate this point.

3. The third part of the document addresses the challenges of human resource management. It discusses the importance of recruiting, training, and retaining a skilled workforce. The text explores different strategies for talent acquisition and employee development, suggesting that a combination of formal training and on-the-job experience is often the most effective. It also touches upon the need for a positive work environment to foster productivity and loyalty.

4. The fourth section deals with financial management and budgeting. It provides insights into how to create realistic budgets, monitor expenses, and manage cash flow effectively. The author stresses the importance of regular financial reviews and the use of budgeting tools to stay on track. Additionally, it offers advice on how to handle unexpected financial challenges and maintain financial stability over the long term.

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