

The NECG Edge

NECG PREDICTS

Newsweek (7/3/00) "Fat for Life? Six Million Kids are Seriously Overweight."

Edge: We predict that in the next 2-3 years, American parents' appetite for goods and services (soda, snacks, prepared foods, diet counseling, and drugs) aimed at children will explode and several new kid health/diet brands will emerge, but most of them will fail because kids will never, ever trade taste for health.

Brandweek (6/12/00): "Purple Reigns . . . Barney Rumbles Back, Stalking Younger Demo."

Edge: We predict that this Barney comeback tour will have many product/partner casualties, but two big winners, Barney himself and PBS. Next up -- the return of the tantalizing Teletubbies!

New York Times (6/6/00): "A very un-Pepsi-like campaign for a new line of fruit drinks."

Edge: Pepsi will launch FruitWorks nationally with grassroots marketing instead of marketing gimmicks such as celebrity endorsers.

How will this ever work -- no Michael Jackson; no little girl!! However, we are confident that this one-on-one marketing approach will be successful in reaching the 'un-Pepsi Generation' -- computer-savvy young people

aged 15 to 24 who want to help create the personality of a new brand. Oh, the joy of un-advertising!!!

New York Times (6/29/00): "Plain Does Not Do Justice to the Original M&M's Candy."

Edge: After 46 years, M&M/Mars has changed the name of its Plain variety to 'Milk Chocolate'. BIG DEAL!!!

We predict that the name change will neither help nor hurt the brand. But, it won't create the 'buzz' of previous campaigns, such as when M&M/Mars announced it was eliminating the red color. The \$10 million multimedia campaign planned would be better spent promoting a limited 'Barney' Purple M&M!

Wall Street Journal (7/5/00): "Venture capital loves Peer-to-Peer", the latest technology fad inspired by the music sharing service Napster."

Edge: We predict that the courts will continue to shut Peer-to-Peer copy schemes like Napster down, but once the masters of traditional Peer-to-Peer marketing (i.e., Avon, Amway, etc.) figure out the Web, watch out.

Supermarket News (6/12/00): "Playing the Loyalty Card- retailers are learning that there's

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more to frequent shopper programs than discounts."

Edge: Kevin Coupe sheds light on this subject, and more, in this issue's Leaders on the Edge interview (see pages 4 and 5). ■

What's Hot, What's Not

Hot!	Not!
Disruptive Technology	Innovation
Emeril Lagasse	Wolfgang Puck
Green Ketchup	Guacamole
Unilever	P&G
The Teenage Millionaire	Warren Buffet

Buy Growth or Buy Synergy?

You are a packaged goods company considering the acquisition of two companies that are each making 5% profit margin on \$100MM in sales, but Company A with 20% expected sales and earnings growth and Company B with 5 points of expected synergistic margin improvement. Quick, which of these companies would you prefer to buy?

The conventional wisdom among many involved in acquisitions seems to be, "I would rather buy growth. Synergies are great in year one but in the next year you've got to beat the number and if you bought a zero growth business, you're in trouble." From the standpoint of stockholder value is this correct?

The answer is probably not. Here's why:

Synergies can create stockholder value faster than growth.

Using simple math to illustrate, if two companies that each have a 5% profit margin are combined, and synergies enable the combined entity to make 10%, total profits would have grown by 100%. It would take 7+ years of 10% growth to achieve the same result.

Further, as the acquiring company, you stand to gain a disproportionate share of the value created for your company. As shown in Exhibit A, if the acquiring company bought the other one for what it is worth independently, \$50MM, it would capture all \$100MM of the

synergies for itself. (\$200MM combined value, less \$50MM paid, less \$50MM original value). It would take 11+ years for a similar sized non-synergistic company growing at 10% to reach the same value creation, or 6 years at 20% growth.

When you buy growth, you pay for it. The value of synergies, on the other hand, can be captured for your shareholders.

Imagine an auction of a growing company that offers no synergies to any potential buyer. The price of that company would be bid up to reflect the expected growth, which would be about the same for each buyer, assuming roughly equivalent information. If you were to pay this price, no shareholder value would be created because the price paid for the expected income stream is simply what it is worth.

Continuing with the hypothetical, if yours were the only company with potential synergies, you could pay more than any other company by one dollar, so to speak, and the value of any synergies above that, would be captured by your shareholders.

EXHIBIT A: STOCKHOLDER VALUE OF SYNERGIES

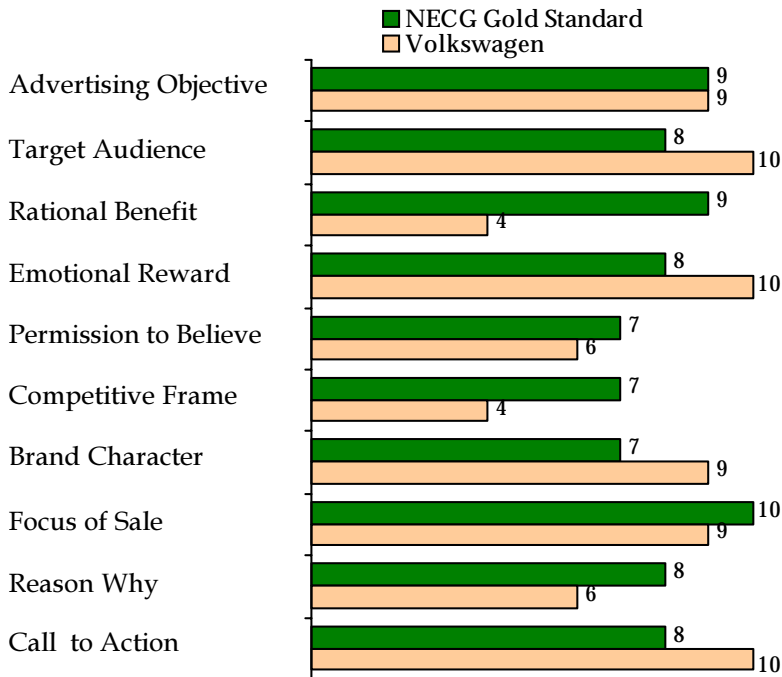
	Acquired Company	Acquiring Division	Total	
			Separate	Combined
Sales - \$MM	100	100	200	200
EBITDA - %	5%	5%	5%	10% (5 pts. synergy)
- \$MM	5	5	10	20
Value @ 10 x EBITDA - \$MM	50	50	100	200

(Continued on page 7)




Volkswagen Campaign

In this issue, Gary Stibel and Bob Lepre rate the Volkswagen “Drivers Wanted” campaign. Since the campaign has many executions on air, Gary and Bob have used the “Shopping Cart” execution for evaluation. The “Shopping Cart” commercial begins with a young man parking his Volkswagen in front of a grocery store and walking away. As he walks away, a loose shopping cart starts rolling down towards the VW, at which point the young man runs back and tackles the cart down like a football player. The voiceover explains how VW owners are passionate about their cars.

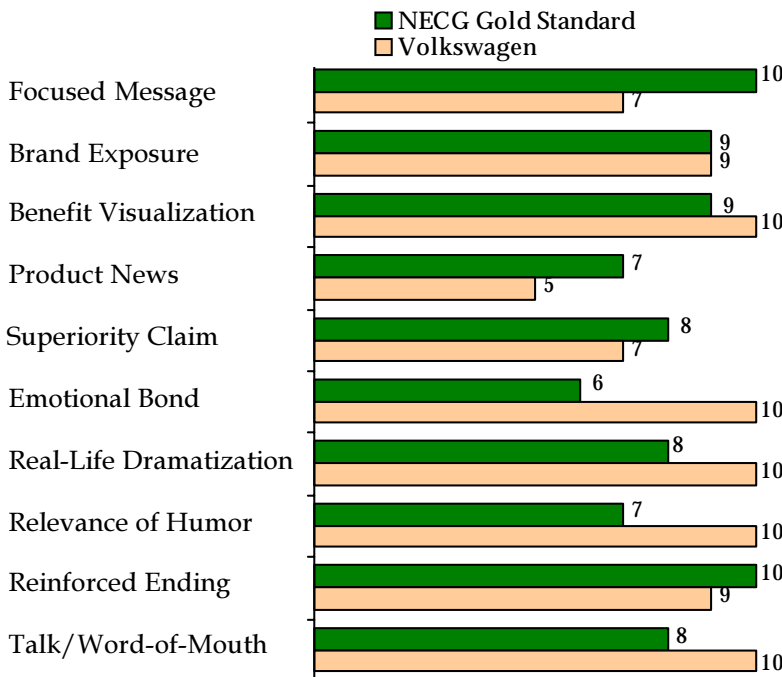


STIBEL ON STRATEGY

“One of the few car campaigns that is focused on a specific target audience and offers the strong emotional reward of belonging to ‘the ultra-hip club’.”




NECG Gold Standard = 81/100
Volkswagen Campaign = 77/100



LEPRE ON EXECUTION

“A wonderful campaign built around a simple but compelling selling proposition: ‘Drivers Wanted’. Proof positive that creative virtuosity and focused strategic insight are alive and well in TV advertising.”



NECG Gold Standard = 82/100
Volkswagen Campaign = 87/100

Kevin Coupe

Leadership Area

☞ Food Retailing

On-the-Edge Accomplishments

- ☞ Twenty years of covering the food distribution business globally -- in video and print.
- ☞ Currently, VP Content Guy of IdeaBeat, the leading online community of food retailing analysis, opinion and interaction.



Edge: Safeway PLC recently abandoned its loyalty card program. Do you think this implies impending death for all retailing loyalty card programs?

KC: No. I think you're going to see a lot of companies reevaluating whether they want to be in the loyalty marketing business. Retailers entered the loyalty marketing business when grocery sales were flat and when Wal*Mart was starting to get into the food business. Loyalty programs were sold as the panacea. When loyalty programs didn't work, retailers started to say, "Well obviously, that's not the answer". However, they didn't ask the right question: not did it work, but rather why didn't it work. Loyalty marketing programs are basically glorified discount programs. What they should have done is to develop programs that continually demonstrated their loyalty to specific consumers in different ways.

Edge: Safeway PLC is abandoning their loyalty program because there is data overload. Do you agree?

KC: Yes, for a large company, absolutely. The big problem for large companies is it creates too much data that they can't possibly figure out how to mine. Furthermore, they don't want to be in the data mining business but are unwilling to turn the data over to other companies because of a sus-

pcion that somehow it won't be their data anymore.

Edge: Why didn't Safeway start over?

KC: It's probably simply a matter of economics, and the fact that the food industry is very much an industry of fads and trends. It was loyalty marketing one year, then meal solutions and then the Internet. Few companies have done it right, if any at all. And the companies that really have done it right are the really small companies.

Edge: Give us some examples . . .

KC: I think companies like Dicks in Wisconsin. They have done a good job of using data to target people with certain kinds of information and e-mails.

Edge: How did small size help Dicks?

KC: Since they're small, they can move quickly, and they had the wisdom to say, if we know A, B, C and D, we can act on A, B, C and D. As opposed to let's gather A-Z and then figure out what we can act on, then realizing they couldn't act on any.

(Continued on page 5)

(Continued from page 4)

Edge: What about some of the bigger retailers like Wegman's?

KC: Wegman's has not done as much with their program as one would expect. Companies like Wegman's don't have to rely on loyalty marketing programs because they have developed a transcendent shopping experience that demonstrates loyalty on an ongoing basis. Frankly, that should be everyone's goal . . . but we know it isn't. If you're going to use loyalty cards, make them work for the consumer. Use them to tell the consumer how and why to use various products in your store, how and why you are different, not just cheaper.

Edge: But it sounds so simple. Why haven't retailers figured it out?

KC: Big companies can't deal with it that way because they operate in silos; marketing people never talk to the data people. Usually, the IT department runs the frequent shopper programs. And therefore, you get a bunch of data-in, and data-out from people who have no idea how it's going to get used.

Edge: Why not turn these programs over to marketing?

KC: It's probably a turf thing in certain companies; it's cultural. Retailers have never dealt with loyalty marketing the way I'm describing; they tend to deal from a data point of view as opposed to the marketing point of view. Don't forget, when I say the store has to continually demonstrate loyalty to its shoppers, that's not something the supermarket industry has ever

done. Historically, it has been, "We'll build it bigger and better, we'll offer selection and good prices, and they will come". Part of the problem with developing a loyalty marketing program that's focused on better prices is that somebody can come in and undercut you.

Edge: Now that Safeway has dropped its loyalty program, will others follow?

KC: If all they're using it for is to deliver coupons/discounts, there's no real reason to start dropping out. Ahold is in a really unique position. If they were to combine store data with Peapod data, they could use the information in a really effective way. They could really grow their business in a unique way and create a barrier to entry for others.

Edge: Aren't online shoppers basically part of a loyalty program?

KC: Absolutely! I've always felt that Amazon.com is the world's best loyalty marketing program. I get e-mail from them all the time because I've willingly given them information about myself.

Edge: How will loyalty programs evolve?

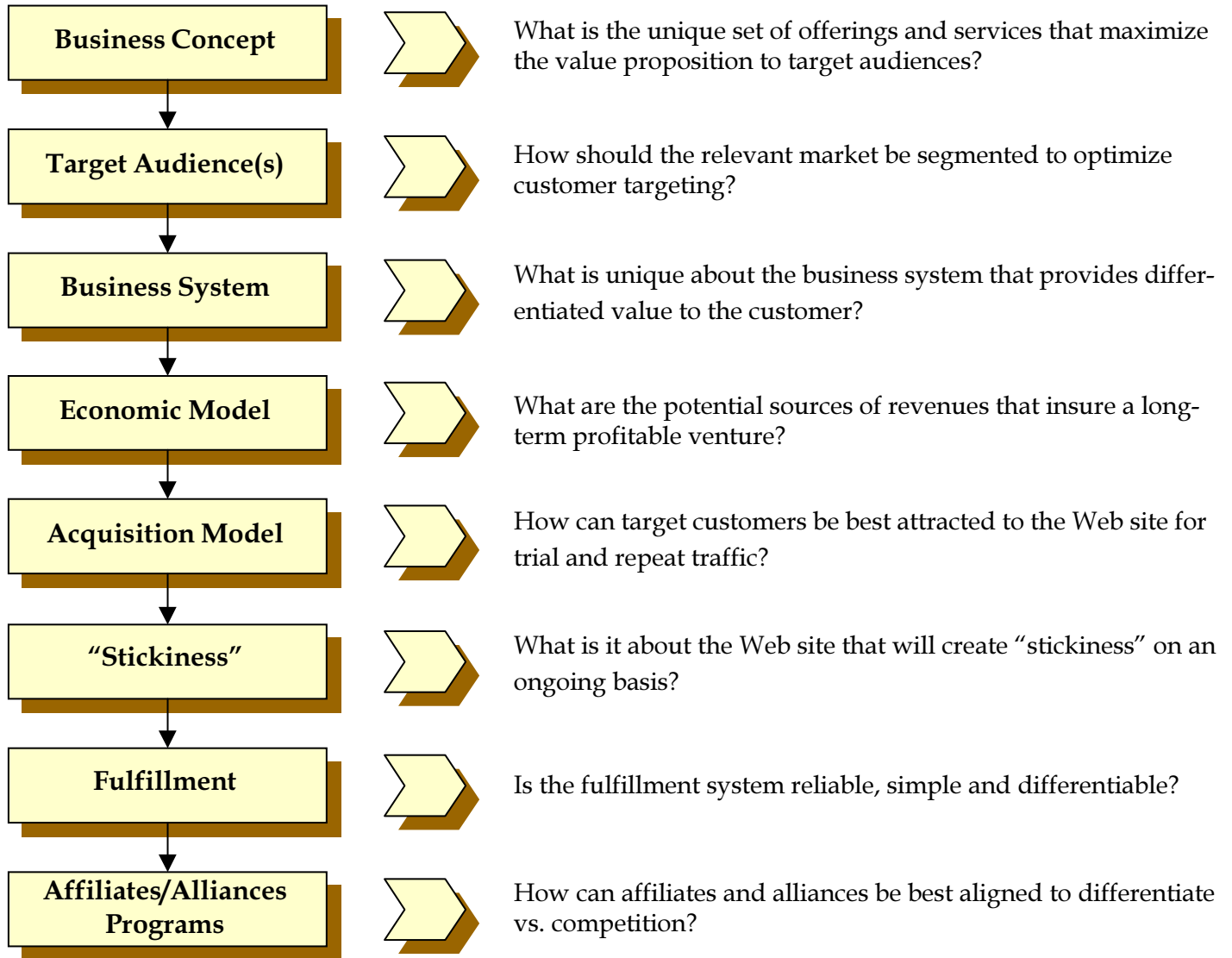
KC: Big retailers are going to say, "We don't need to be in loyalty marketing; we are ubiquitous. We may continually have programs that deliver electronic discounts to people, but we don't need to mine the data". And the small retailers will say, "For us to survive, we just simply need to know more about our customers". ■

For more on food retailing, please go to IdeaBeat.com.

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Internet Business RoadMap

The fall of many Internet start-ups can be attributed to lack of sound business planning and management. NECG's Internet Business RoadMap provides a structured approach that can be used by Internet start-up to develop long-term profitable businesses.

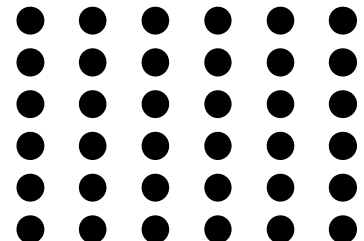


INSIGHT

On average, a consumer spends less than 2.5 seconds looking at a food product in the supermarket. However, more than 34 new food products are introduced everyday.

PUZZLE

TAKE AWAY SIX COINS so that all the rows that are left contain an even number, whether reckoned vertically, horizontally or corner-to-corner



(Continued from page 2)

Growth doesn't go to the sky.

Growth is often overvalued in analysts' projections. When you buy a growing company, it has probably already been growing for at least 5-6 years. Usually a realistic projection of continued growth would be 4-5 years, rather than the 10 years or longer we sometimes see in valuation spreadsheets. (When was the last time you saw a run of more than ten years?)

Projecting growth in perpetuity, or even 10 years, does not reflect the way the market values earnings growth. If you add \$10MM to a large cap company's EBITDA, the market value of the total will go up by roughly \$100MM – a multiple of about 10X even if those earnings are expected to grow by 20% per year. The market is relatively insensitive to a small piece of a large whole that is growing more rapidly. Maybe it is irrational – perhaps it just reflects the reality that future growth is risky in addition to being discounted.

So, back to the original question. Which company would you prefer -- the one that is growing rapidly or the one that offers synergies? The answer obviously depends on the price paid for the two companies. If you could pay the same price for both, you would be roughly indifferent. But, and here's the catch, you wouldn't be able to pay the same amount for the two companies.

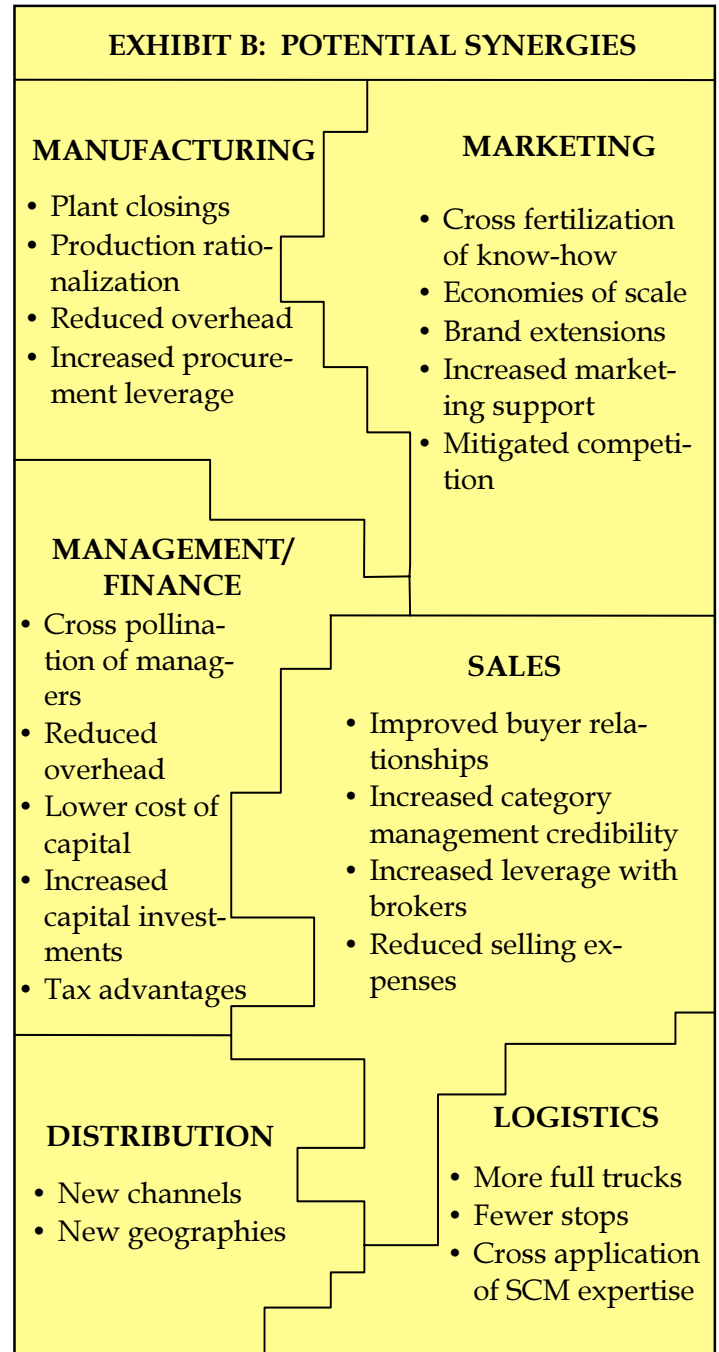
Since company A is growing, its price would be bid up significantly higher than that of company B. In fact, you would probably have to pay 2-3 times as much for company A as company B, even though it is worth about the same in shareholder value.

Synergies are real.

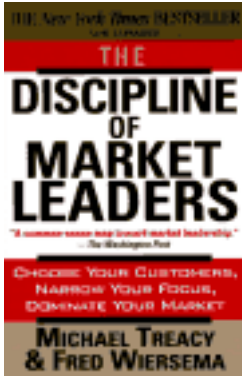
If buying synergies is better for stockholder value, why don't more companies do it. The answer is they often underestimate synergies. Synergies are not just cost reductions resulting from layoffs, plant rationalization and the like.

Value is created when combining two companies enables business improvements – either cost reductions or top-line growth – that were not possible for either company separately. This covers a lot of ground, as

shown in Exhibit B on what the potential synergies are and how they apply. This extensive list illustrates why predicting and tracking them all can be difficult, and more importantly, why their cumulative effect can be enormous. ■



This article was written by David West, Principal of NECG. Send your comments and opinions to David at dww@TheNECG.com.



“The Discipline of Market Leaders”

Amazon Ranking
★★★★

NECG Edge Ranking
★★★

“The Discipline of Market Leaders” by Michael Treacy and Fred Wiersema

The Edge believes that successful companies have a unique value proposition that is generated by developing advantages not just in one business function, but throughout the business system. ‘The Discipline of Market Leaders’ argues that no company can succeed today by trying to be all things to all people. It must instead find the unique value that it alone can deliver to a chosen market.

The three recurring concepts in the book are:

- *Value Proposition* – Promise a company makes to customers to deliver certain values such as price, quality, selection and convenience.
- *Value-Driven Operating Model* – Combination of operating processes, management systems, business structure, and culture which gives a company the capacity to deliver on its value proposition.
- *Value Disciplines* – Three ways in which companies combine operating models and value propositions to offer value to consumers.

Specifically, the three Value Disciplines are:

- *Operational Excellence* – Providing middle-of-the-market products at the best price with the least inconvenience.

- *Product Leadership* – Offering products that push performance boundaries and use continuous innovation.
- *Customer Intimacy* – Delivering not what the mainstream market wants, but what specific customers want.

Market leaders believe in four important rules which characterize the new world of competition.

1. Provide the best offering in the marketplace by excelling in a specific dimension of value.
2. Maintain threshold standards in other dimensions of value.
3. Dominate your market by improving value year after year.
4. Build a well-tuned operating model dedicated to delivering unmatched value.

The Edge believes that the fundamental principles discussed in this book are sound and are very similar to Michael Porter’s competitive strategies of low cost, differentiation and focus. However, the Edge also believes that the book fails to discuss the most important discipline of market leaders -- having a clear vision for the future. The Edge has found that most successful companies don’t just improve on what they have today, they know what they ought to have tomorrow and work towards it. ■



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