Academic Review

The Role of Standards
Current Practices,
Needs, Qualifications,
Value Proposition

David Stewart, USC and Project Chairman

February, 2007

THE BOARDROOM PROJECT

Overview of Today's Presentation

- What is ROMI?
- State of the Practice
- Role of Standards and Standardized Measures
- Three Types of ROMI and Measurement
- An Audit Process for Selecting and Linking Marketing Metrics to Financial Performance
- Summary

What is ROMI?

…defined as the revenue (or margin) generated by a marketing program divided by the cost of that program at a given risk level.

Guy R. Powell (2002), Return on Marketing Investment, (Albuquerque, NM: RPI Press), p. 6.

This is an economic (financial) measure!

What is ROMI?

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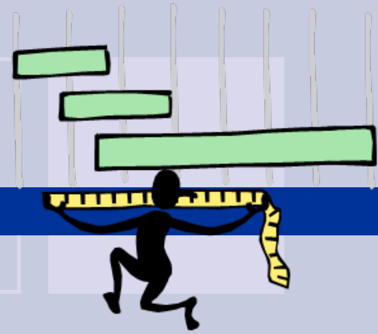
Not necessarily a measure of:

- Brand equity or Loyalty
- Awareness or preference

Why ROMI Must Be A Financial Metric



- It's the ***Language*** of the company
- It's the way companies ***report*** and are evaluated
- It's the way to ***compare*** alternative actions
  - Across products, markets, customers
- It provides ***accountability***
- It promotes ***organizational learning*** and cross-functional team work
- It's the Way to Answer Questions about the . . .

"***Optimal Marketing Mix***"

Disappointment with Marketing Metrics

- Challenge for marketers is to define measurement metrics

Julie A. Woods, "Communication ROI," <u>Communication World</u>, 21 (Jan./Feb. 2004), 14.

- A mixed record of success across all industries:
  - Good results with promotions and price
  - Limited success with product strategy, advertising and distribution management

Randolph E. Bucklin and Sunil Gupta, "Commercial Use of UPC Scanner Data: Industry and Academic Perspectives," <u>Marketing Science</u>, 18 (3, 1999), 247-273.

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What’s Happening In the Practice?

- Conferences
- Task Forces
- Books
- White Papers
- Surveys of Current Practices

But, No real outreach to the financial community

A Flurry of Recent Books

- *Accountable Marketing* (Rosenwald)
- *Return on Marketing Investment* (Powell)
- *Marketing ROI* (Lenskold)
- *Marketing and the Bottom Line* (Ambler)
- *Marketing by the Dashboard Light* (LaPointe)
- *Marketing Metrics: 50+ Metrics Every Executive Should Master* (Farris, et al.)
- *Measuring Marketing: 103 Key Metrics Every Marketer Needs (Davis)*
- *Marketing Champions: Practical Strategies for Improving Marketing's Power, Influence, and Business Impact* (Young, et al.)
- *Sales and Marketing, The Six Sigma Way* (Webb and Gorman)
- *Competing for Customers and Capital* (Cook)

White Papers

- **ANA Marketing Accountability Task Force (2005)**
- **Chief Marketing Officers Council's Marketing Measures Performance Audit (2004)**
- **American Marketing Association's Marketing Accountability Study White Paper (2005)**

Regulations, Litigation, Turmoil and Change

- Sarbanes-Oxley (2002)
- 

- Higher Profile Improprieties
- Average tenure of CMO is 23 months*

* Spencer Stewart

Surveys of Industry Practices

1. American Productivity and Quality Center with Advertising Research Foundation (2001/2003)
2. Chief Marketing Officers Council Marketing Measures Performance Audit (2004)
3. Association of National Advertisers/Forrester (2002/2004/2006)

Key Findings of APQC/ARF Surveys

- Pressure to deliver *quantifiable returns*. Need for reliable, valid, and relevant metrics.
- Development of *econometric marketing mix models* enable organizations to achieve competitive advantage and increase profitability.
- ROI-based marketing has demonstrable *positive results* and big payback.
- Marketing Mix Modeling *informs judgment*, changes planning processes, implementation, and the way marketing programs are evaluated.
- Companywide ROI approach can *facilitate learning*.
- Knowledge systems built around ROI *enhance team work*.

CMO's Marketing Measures and Metrics Report

- Survey of Over 1000 CXO's Including 320 CMO's
  - Companies represent $ 400 billion in annual sales
  - Up to 25% of revenue spent on marketing
  - Technology Focus

"Measures and Metrics: The Marketing Performance Measurement Audit, Assessing Marketing's Value and Impact," June 9, 2004. http://www.cmocouncil.org/resources.html

Key Findings of the CMO Survey

- **Marketing Performance Metrics viewed as a significant priority by more than 90% of Marketing Executives**
  - —**Greater demands for *accountability* by management and boards**
  - —**Drive for greater effectiveness . . . *Continuous improvement***
- **Over 80% of Marketing Executives unhappy with current ability to measure performance**
  - —**Only 17% have comprehensive system**
    - ***These companies outperformed others in revenue growth, market share, profitability***
    - **Marketing at these companies enjoyed greater CEO confidence**

CMO Satisfaction and Dissatisfaction

- **Greatest satisfaction with measures for direct response marketing (Direct Mail, e-mail Campaigns, Web Site Statistics, Telemarketing)**

- **Least satisfaction with measures of branding, channel marketing, sales and marketing collateral, advertising**
  - **Softer, “brand building” areas**
  - **Areas of greatest expenditure**

Most Important Metrics Among CMO's

1. Revenue
2. Qualified sales lead generation
3. Sales and channel feedback
4. ROI for marketing programs
5. Customer retention, loyalty and satisfaction

Least Important Measures for CMO's

6. Perceptual surveys
7. Traditional measures of Brand Equity
   - Measures of Awareness, Associations

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The Challenge Is “Process”

- Standard processes **and** automated systems **for** consistent data capture **(data repository)**
  - **Most are “in-house” systems**
  - **Practices often lack consistency**
  - **Desire for third party solutions**
- Need for:
  - **Guidelines for processes and metrics**
  - **Models for linking customer purchase behavior to marketing programs**
  - **Executive “dashboard” reporting**

2004 CMO Survey

Some Common Threads

- **Both APQC/ARF Surveys & CMO Survey Emphasize:**
  - **Need for standards and metrics**
  - **Organizational and process changes**
  - **Importance of marketing mix modeling**
  - **Role of third party providers of metrics**
  - **Criticality of “hard” economic outcome measures**

ANA/Forrester Survey on ROMI

- Survey of 300 Members of Association of National Advertisers (Advertising Age, July 26, 2004) (54 respondents)
  - No consensus on how to define or measure ROI on advertising
    - Definitions differ even within same organization
    - More than 15 different definitions
  - Follow-up to earlier survey
    - Little change in two years
    - Presented at the ANA 2004 Marketing Accountability Forum

Summary of ANA Survey Results

- **Measurement is** *difficult*
- *Defining* **"marketing ROI" is the issue**
- **Good measurement creates new challenges**
  - *Speed*: **Timely response**
  - *Change*: **adopting new practices**
- **Market mix modeling will rapidly gain adherents**
- **Measurement will move to external, third-party organizations**

The MATF Task Force Report

"Every other function is held accountable for its return on investment. No longer can marketing expect a free pass from management and shareholders.

Every other function has been six sigma'ed and TQM'ed into fighting trim.

Ignorance of the law of ROI is no longer an effective defense.

(They) cannot fulfill their role as drivers of growth and as satisfiers of consumer needs unless, and until, they prove the worth of their function.

The focus on accountability has an ethical aspect…these funds belong to shareholders who have a right to expect more professional stewardship…

The modern marketer is beginning to see marketing as a 'process' with measurable inputs and outputs producing reliable, repeatable results. The process approach which revolutionized the supply side has finally come to the demand side."

ANA: Marketing Accountability Task Force Report, October 2005

MATF Metrics Catalogue

20 Page Catalogue

13 Strategic Intents (e.g. Advertising Copy)

77 “Classes” of Metrics (e.g. *persuasion*)

No information as to how the strategic intents or classes of metrics tie to the financial performance of the firm…
nor recognition that specific methodologies within classes of metrics often yield very different levels of reliability & validity.

ANA: Marketing Accountability Task Force Report, October 2005

Is Marketing Mix Modeling the Answer?

Mixed record of success:

- **Good results with promotions and price**
- **Limited success with product strategy advertising and distribution management**

Randolph E. Bucklin and Sunil Gupta, "Commercial Use of UPC Scanner Data: Industry and Academic Perspectives," Marketing Science, 18 (3, 1999), 247-273.

Data, Measurement and Models

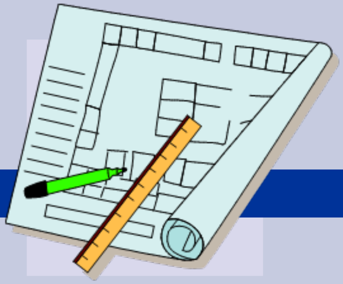
- Models are often limited by the data
  - Not everything is measured
  - Reliability of data can vary with source
  - Validity . . . We measure what we can
- Models cannot substitute for good measures
- Models look backward
  - Forward calibration is infrequent
- Data streams often lack temporal or geographic synchrony
- Mismatch between what is tested or measured and the actions in market

Framing the Problem

Marketing does not lack measures, but…

- It lacks ***standard*** measures and metrics
- It lacks metrics explicitly linked to ***financial*** performance in predictable ways
- In many areas, but not all, it lacks formal processes for ***auditing*** marketing metrics models
- It is highly ***idiosyncratic***
  - You cannot improve a process until it has been defined

An Analogy: The Quality Movement



Marketing is where quality was 50 years ago

- Highly idiosyncratic
- Viewed as a cost (Scrap and re-work as “Low Cost” substitutes for quality)
- Lacking consistent metrics
- Lacking standardized processes

The quality movement has spent 50 years proving itself

- Developing metrics
- Creating standard processes
- Linking to financial performance (through demonstrated cost savings <u>and</u> higher returns in the market)
- Demonstrating its value

What Marketing Can Learn from the Quality Movement?

- Establishing standards is important
- Even in idiosyncratic environments it is possible to create Metrics and processes that
  - Are standard across firms and industries
  - Reduce costs and increase returns
  - Increase value to the firm and the customer
  - Provide a basis for continuous improvement

The Need for Marketing Standards

"We found packaged goods companies to be bombarded with a variety of methods from third-party consultants, the details of which are often not disclosed to clients or outsiders. This creates methods confusion and makes it impossible to compare results and resolve controversies. …this problem is most acute in the area of advertising. We believe that it may be quite helpful …to actively promote open discussion and debate to help establish methods standards ..."

Bucklin and Gupta 1999

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The Role of Standards

Standards are a public good available to both buyers and sellers and provide means for discriminating high from low quality. If buyers cannot distinguish a high quality seller from low quality seller, the high quality seller's costs cannot exceed those of the low quality seller and the high quality seller will not survive. This is called adverse selection or the moral hazard problem in economics.

Past Solutions to the Problem:

- Buyer Screening of Sellers
- Sellers build lasting reputation or guarantee a certain level of quality
- Government intervention

Standards Must Be Linked to Something

- Marketing standards must be linked to the objectives of the firm
  - Financial performance
  - Growth
- Marketing standards must be linked to the common language of the firm
  - Financial performance
  - Shareholder value
- Marketing standards must reflect both revenue and costs

Cash Flow Is the Ultimate Marketing Metric

- Cash flow is the primary financial metric of the firm
  - — It is a measure that is consistent across markets, products, customers, and activities
- The objective of marketing is to identify sources of and to produce cash flow
- There are a small number of drivers of cash flow
  - — Cash is obtained from a source (customer acquisition and retention, share of wallet within category, share of wallet across category)
  - — Cash is produced through a business model (margin, velocity, leverage)
- Every marketing activity should be causally linked to these drivers and ultimately to cash flow
- Intermediate marketing metrics may be useful and even necessary to make this causal link
  - — Such intermediate metrics must be validated and tested against cash flow

Cash Flow Drivers

Source

- Customer Acquisition and Retention**: obtaining new customers and holding current customers (increasing and managing customer base)**
- Share of Wallet within Category**: increasing frequency of purchasing relative to competition and sometimes increasing category consumption (e.g., increasing market share or size of category)**
- Share of Wallet across Categories**: selling additional products/offerings to existing customers (new offerings for existing customers; cross selling)**

Business Model

- Margin: **"profit", net income divided by sales revenue**
  - **Net Income/Revenue**
- Velocity: **"asset turns", amount sold within a given time period**
  - **Revenue/Assets**
- Leverage: **"equity multiplier", efficient and effective use of assets**
  - **Assets/Equity**
- ROE **= (Net Income/Revenue) • (Revenue/Assets) • (Assets/Equity)**

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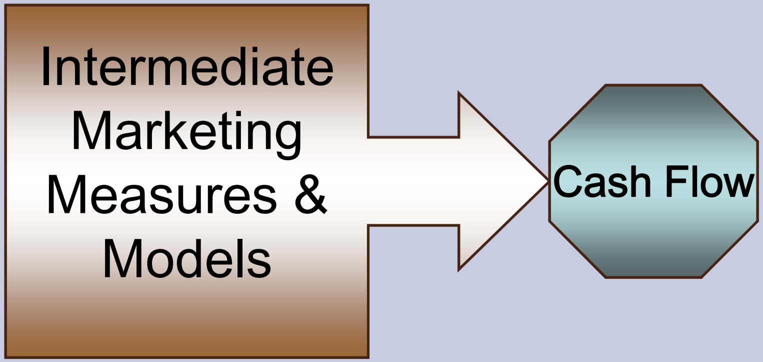
Three Types of Return on Marketing Investment

Return of Marketing Investment (ROMI)

Short-term (Incremental) Effects	Long-term (Persistent) Effects	Real Options
Incremental Sales	Baseline	Future Opportunities
Candidate for Shared Standards	**Candidate for Shared Standards**	**Idiosyncratic to Firm**

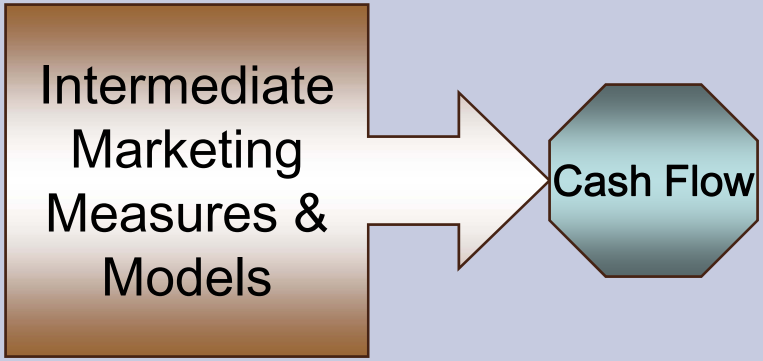
Short-Term Incremental Impact

- **Incremental Sales (relative to a base)**
  - **Larger sales**
- **Sales Not Lost to Competitors**
- **Leads Generated**
- **Close Rate**
- **Awareness**
- **Brand Preference/Choice**
- **Purchase Intention**
- **Web Visits**
- **Permission Subscriptions**
- **Call Center Contacts**
- **Store Visits**



Long-Term (Baseline) Impact

- Actions today alter base
- Base
  - Market Share
  - Sales Volume
  - Brand Equity
  - Brand Preference
  - Customer Loyalty/Retention



Real Options

- Flexibility or opportunities in the future
  - "Optionality"
  - These have value
- Examples
  - Internet site facilitates future actions
  - Cooperative ads yield greater distribution or shelf space
  - Investing in a customer is opportunity for future sales (aftermarket, cross-selling, replacement, repurchase, referral)
- Brand is just a special case of an option

Timothy A. Luehrman in two Harvard Business Review articles: "Investment Opportunities as Real Options: Getting Started on the Numbers" (July-August 1998) and "Strategy as a Portfolio of Real Options" (September-October 1998)

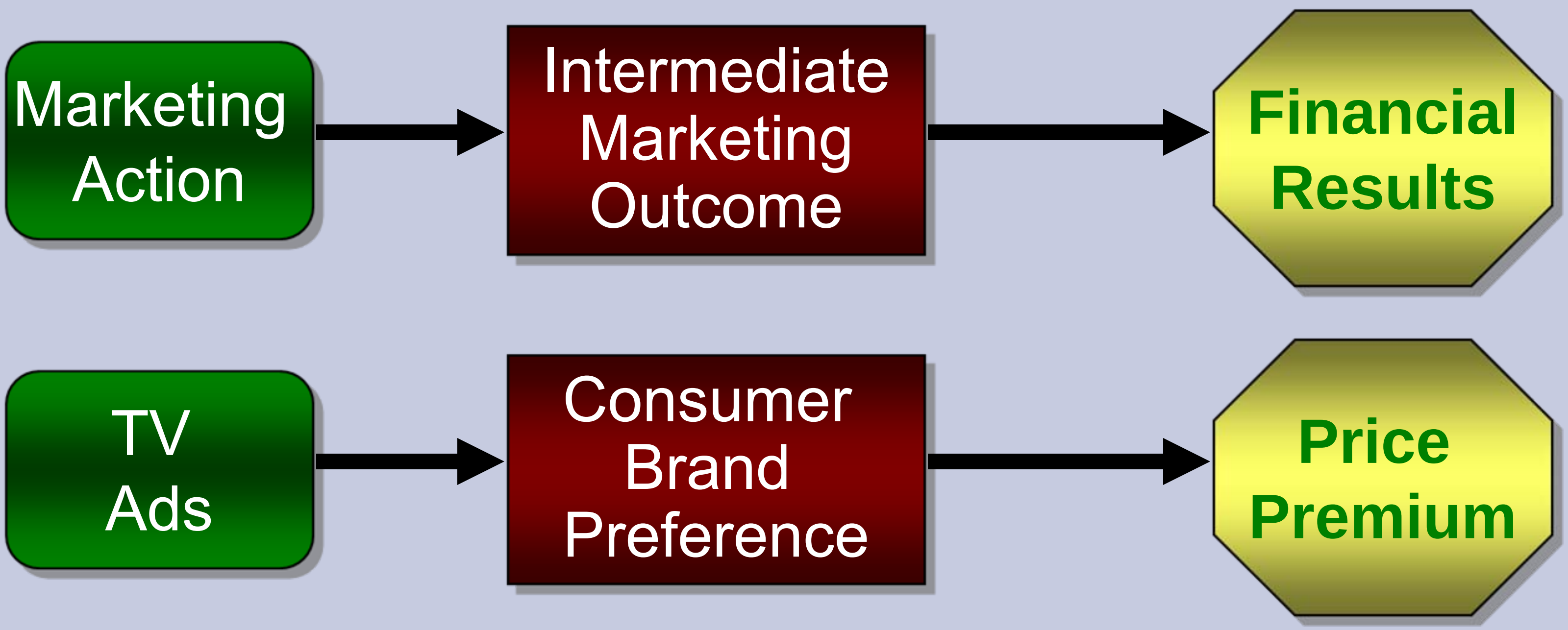
The Value of Options

- Options are unique to the firm
- As much as half the value of a firm is derived from the options (opportunities) the firm has in the future

Pindyck, Robert s (1988), "Irreversible Investment, Capital Choice, and the Value of the Firm," American Economics Review, 78, 969-985

Linking Marketing Outcomes to Financial Performance

There Is a Need to Causally Link Specific Marketing Actions and Intermediate Marketing Outcomes to Each of These Three Types of Returns to Marketing



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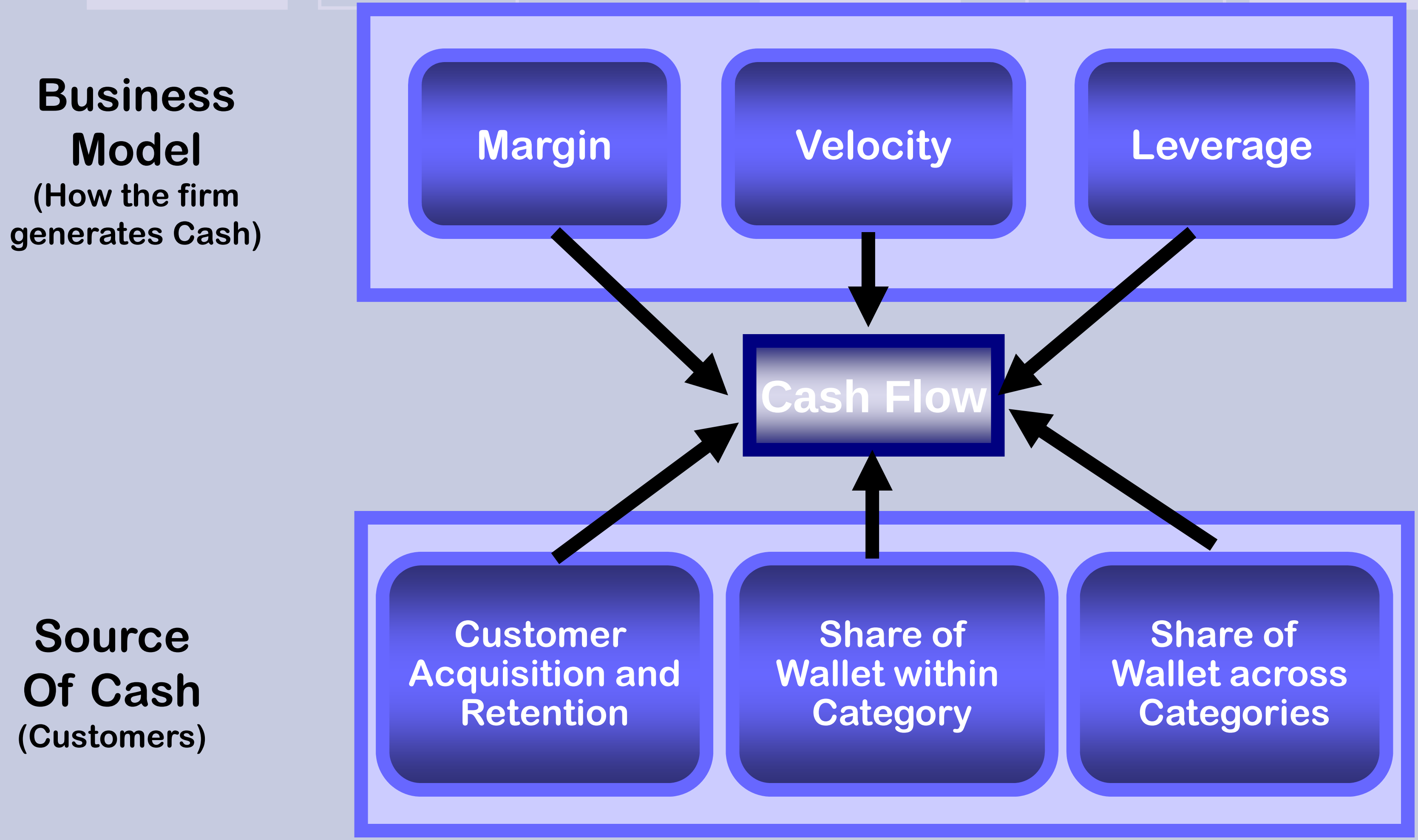
Marketing Metric Audit Protocol (MMAP)

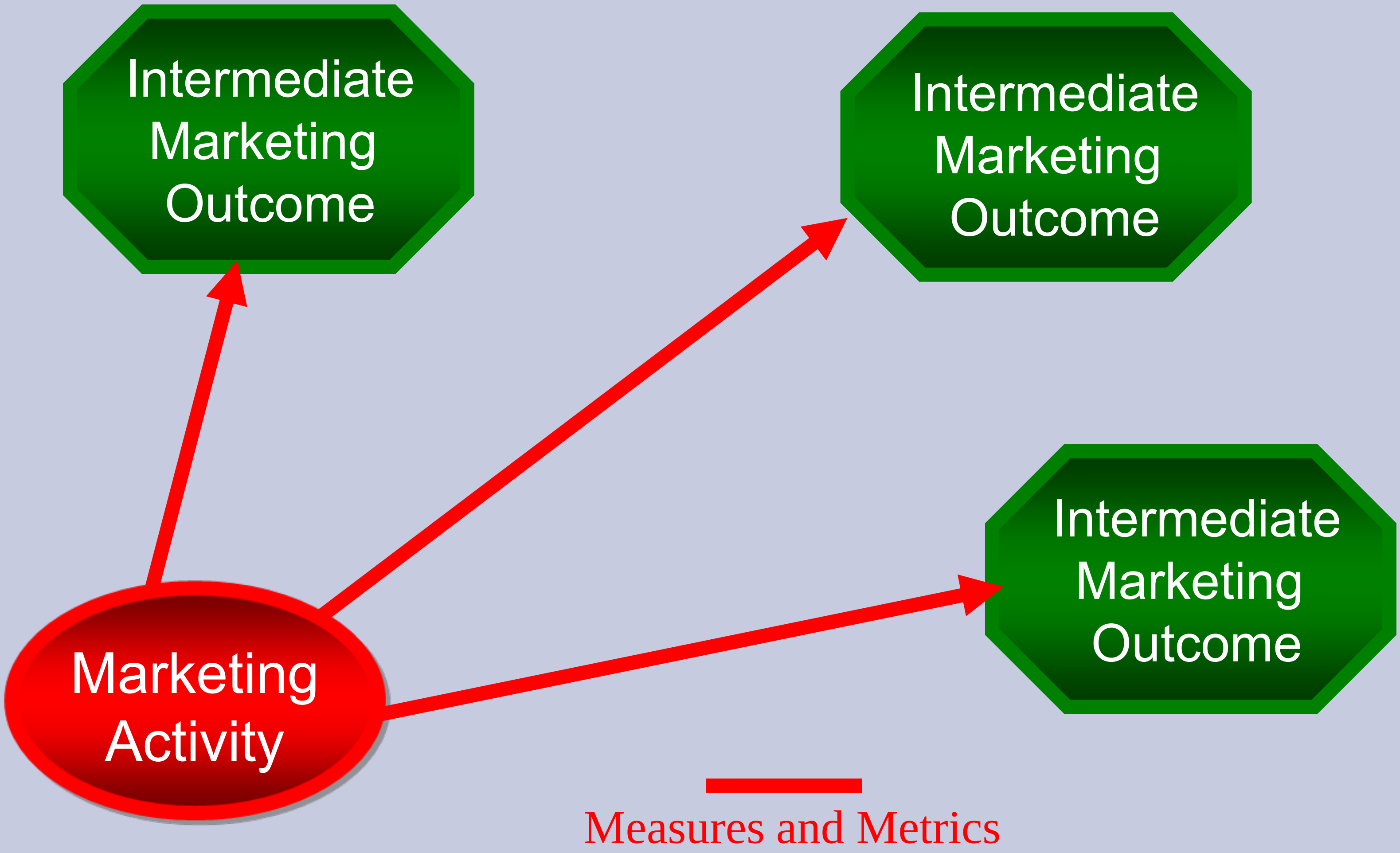
A formal process to:

- Identify the drivers of cash flow (financial results)
- Link marketing activities to marketing metrics
- Link marketing metrics to drivers of cash flow
- Identify & test assumptions (validity and causality)

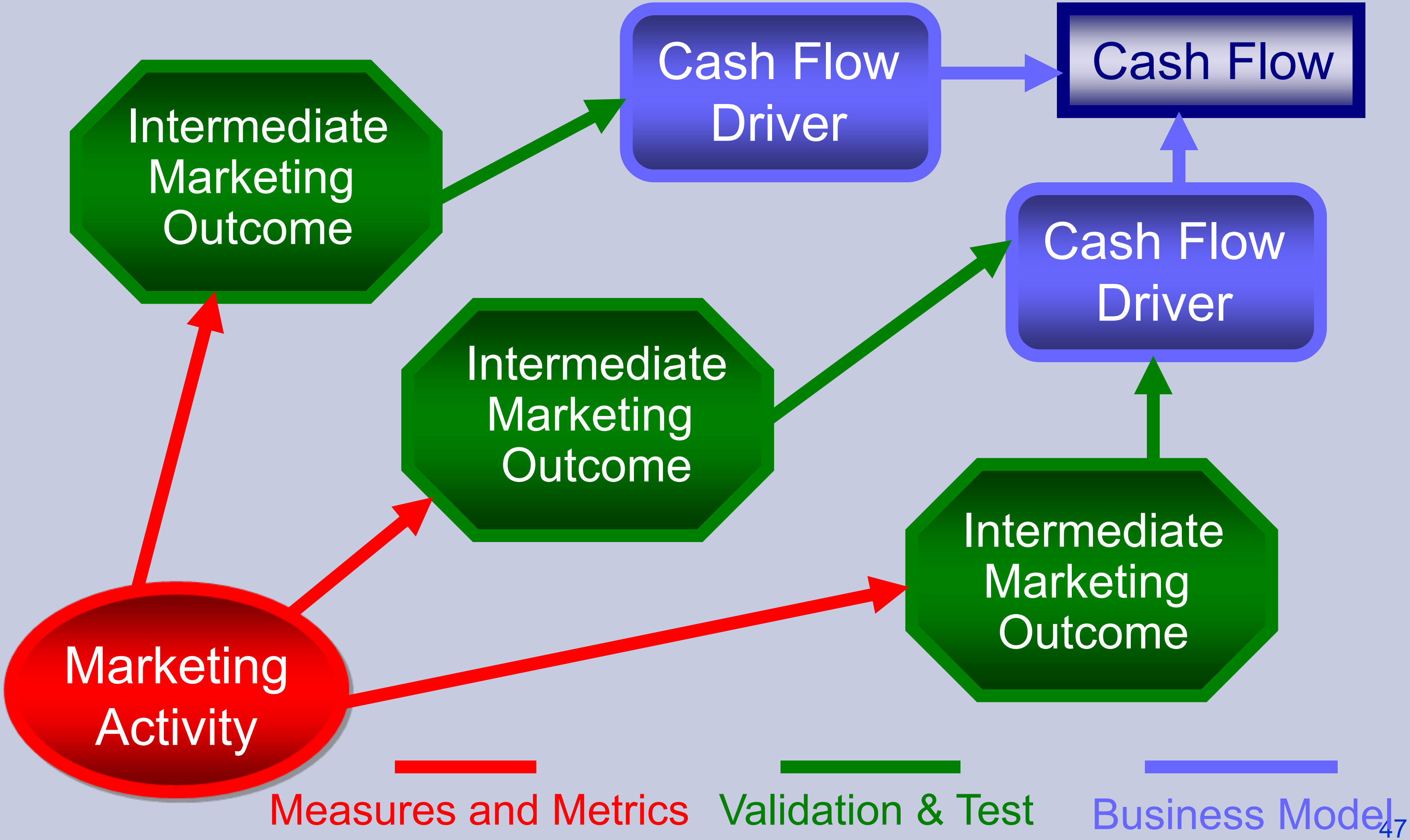
Step 1: Identify Cash Flow Drivers/Business Model



Step 2: Identify Intermediate Outcome Metrics



Step 3: Identify the Conceptual Links



Step 3: Conceptual Links of Intermediate Outcome Metrics to Cash Flow Drivers (Example)

	Cash Flow Drivers					
	Source of Cash			**Business Model**		
	Customer Acquisition and Retention	Share of Wallet Within Category	Share of Wallet Across Category	Margin	Velocity	Leverage
Intermediate Marketing Outcome Metric						
Market Share		√		√		
Leads Generated	√			√	√	
Purchase Intent	√				√	
Brand Preference (Equity; Loyalty)	√	√	√	√	√	√
Customer Satisfaction (Retention; Loyalty)	√		√	√		
Coupon Redemption Rate		√			√	
Distribution Levels	√	√			√	

Note: this will be done for both short-term and long-term

Steps in the Marketing Metric Audit Protocol

Step 1: Identify Cash Flow Drivers

- **There will be at least one source of cash <u>and</u> one business model**
- **In many businesses there is a dominant source and a dominant model**

Step 2: Identify Intermediate Measures of Marketing Outcomes

- **Distinguish between measures of efficiency, like CPM and cost per lead, and measures of effectiveness, like redemption rate for coupons and market share**
- **Focus first on measures of effectiveness**

Step 3: Identify the Conceptual Links

- **Every marketing action should have an identified outcome metric**
- **If there is no logical link between a marketing outcome and a cash flow driver you might question the need for the associated marketing activity**

Step 4: Identify the Causal Links (validation & causality)

- **When there is uncertainty about the causal link between a marketing outcome and one or more cash flow drivers, validation or test is appropriate, especially if the costs of the marketing activity are high**

Validation and Causality Audit

- Every intermediate marketing outcome metric should be validated against short-term or long-term cash flow drivers and ultimately cash flow
    - This will cost money, but
    - It will facilitate forward forecasting & improvement …which should be the criteria for validation

Characteristics of a Sound Metric

1. Relevant…addresses specific pending action
2. Predictive…accurately predicts outcome of pending action
3. Objective…not subject to personal interpretation
4. Calibrated…means the same across conditions & cultures
5. Reliable…dependable & stable over time
6. Sensitive…identifies meaningful differences in outcomes
7. Simple…uncomplicated meaning & implications clear
8. Causal…course of action leads to improvement
9. Transparent…subject to independent audit
10. Quality Assured…formal on-going QA processes

Conclusion

1. ROMI is no longer an option
   - There is much unnecessary confusion about ROMI.
   - ROMI is ultimately about economic outcomes financial results
2. Need standard measures related to short-term incremental results *and* longer-term effects linked to cash flow
   - Forecasting future outcomes
   - Evaluation of past actions
   - Allocation of resources
   - Evaluation of alternative action plans
- Improvement over time
3. The solution will arise in a competitive market if firms invest in standardized metrics and a formal audit process

But, who or what will drive this process?

A Marketing Accountability Standards Board (MASB)

A broad based, independent organization modeled after the Financial Accounting Standards Board

An organization that fosters dialog between marketing and finance

“Why do we need another organization looking at the question of marketing accountability and metrics, how will it be different, what will it do that adds value?

At a very high level the answers are:

- To take a broad view, rather than looking only at a specific activity like television advertising or the internet.
- To create an independent organization that does not bring vested interests to the table and can therefore be more impartial (even if this just means assuring that all of the interests are at the same table).
- No other body has stepped forward to try to coordinate all of the many efforts now underway.
- It makes no sense to try to create a common vocabulary or a standard process if these are only standard within a single domain. They need to be shared and coordinated across domains (advertising, personal selling, promotions, Internet, etc.).