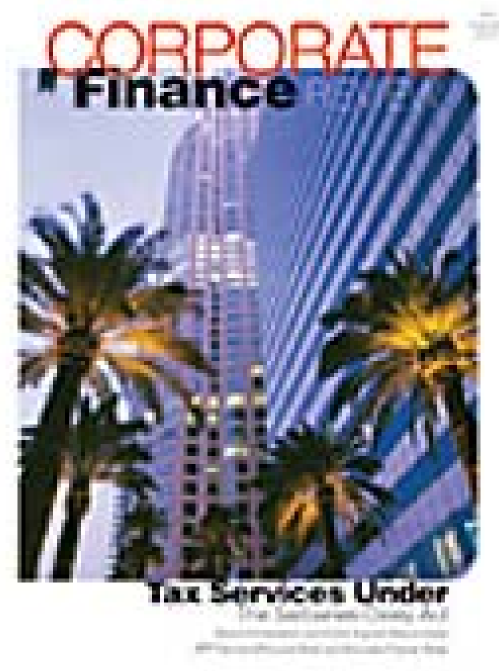

David Stewart in October 2006 Issue of *Corporate Finance Review*;
"Putting Financial Discipline in Marketing: A Call to Action"

Executive Summary

There is increasing scrutiny of marketing activities and a growing demand for greater accountability of the marketing function. The article asserts that such accountability cannot be achieved without the adoption of generally accepted standards for the measurement of marketing outcomes that are explicitly linked to the financial performance in predictable ways. These marketing metric standards must be grounded in the business model of the firm and aligned with the company's financial reporting and business decision making processes. The article contends that every marketing activity leads to an intermediate marketing outcome which ultimately drives cash flow and proposes a 'marketing metric audit protocol' for validating this causal link between marketing activities and the financial performance of the firm. Corporations are invited to respond to this call to action for the industry by contacting and supporting the Marketing Accountability Standards Board, formed in 2004 by a group of marketing scientists with a mission to "establish marketing measurement standards for continuous improvement in financial performance."

THE BOARDROOM PROJECT

Putting Financial Discipline in Marketing: A Call to Action

The demands for accountability and the justification of expenditures within the marketing discipline have reached epic proportions. While few would disagree with the view that marketing is important and adds value to the firm and for the customer, measuring and quantifying such contributions remain a challenge. As one publication recently noted, “Marketing -- known more as art than science -- has been the last of the corporate functions to formally develop and adopt processes and standards that can be tracked and measured quantitatively.” (CMO Council 2004)

Even as pressure from senior executives and boards of directors for greater marketing accountability has mounted, recent legislation has added to the challenge. Sarbanes-Oxley places marketing directly in the sights of regulators, senior management and the corporate board. Projections by marketers are used by virtually all other functions within the firm. As a result the marketing function will be required to provide more accurate and complete information about both the return on marketing expenditures and its projections of future results.

The imperative for greater accountability exists within an environment in which there is little agreement on how to measure the contributions and outcomes associated with marketing activities. Indeed, there is no generally accepted definition of return on marketing investment even within the same organizations (Nail 2004; CMO Council 2004) and the vast majority of firms are ill-prepared to generate the types of accountability measures that will be required in the future. Marketing requires generally accepted measurement standards and processes if it is to meet the challenge of accountability and retain credibility in the boardroom. Should marketing fail to develop such measurement standards, other business functions will certainly do so and there is a risk that marketing will be marginalized as just a tactical function to be managed by more strategic disciplines.

Why Marketing Must Be Accountable in Financial Terms

Marketing has a long history of attention to measurement and the creation of metrics, yet most of the metrics used to assess the outcomes of marketing activities are tactical and not directly linked to the overall financial performance of the firm. It is critical that measures of return on marketing investment be firmly grounded in the business model of the firm to provide decision makers with information and direction regarding economic and financial outcomes. The availability of these measures should also be consistent with the timing of the firm’s financial reporting and decision-making processes.

There are several reasons for following a return on investment approach. First and most importantly, if marketing is to be a credible contributor to the strategic success of the firm, it must speak the same financial language as the rest of the firm, and it must translate outcomes into economic metrics comprehensible outside the marketing department. Second, economic metrics, or metrics that can be clearly linked to economic outcomes, are the only measures that provide managers with the information necessary for planning, budgeting and prioritization. Even actions with relatively comparable outcomes, such as scheduling media within the same medium, require a common metric that informs allocation decisions.

Most management decisions involve allocation of limited resources among alternative tactical actions that may have non-comparable outcomes. It is impossible to be confident in any decision involving non-comparable alternatives unless their outcomes can be translated to a common scale: the decision to invest more in a firm’s website must be weighed against developing and running more television advertising; the cost for exclusive pouring rights at a particular venue for a soft drink manufacturer must be weighed against the alternative of increased advertising in traditional media; investment in one market or product must be weighed against investment in other markets or products. In short, any marketing expenditure must be weighed against alternative marketing and non-marketing investments, and measured against the potential for increasing profitability as a result of marketing in a given quarter versus not making the expenditure at all.

The Standards Imperative

Common excuses for the failure to link marketing to the bottom line of the firm include the creative and idiosyncratic nature of marketing activities, the fact that many marketing activities have long-term, as well as short term outcomes, and the concern that financial accountability will lead to reduces creativity and a short-term orientation. While there is an element of truth in these concerns, none can excuse the failure to hold marketing accountable in terms that quantifiable and linked to financial performance. Similar excuses were once the norm in operations, but are not tolerated today.

Marketing is where the Quality Movement was 50 years ago. It is highly idiosyncratic, is typically viewed as a cost (scrap and re-work as "low cost" substitutes for quality), lacks standard metrics and lacks standardized processes -- read more marketing expenditures for more programs. The Quality Movement has spent 50 years proving itself (and this has cost money). It has done so by developing common metrics, creating standard processes, linking to financial performance (through demonstrated cost savings and higher returns in the market), and demonstrating its value to the firm.

Much of the current frustration with assessing marketing's effectiveness grows directly from the absence of such standards and a common language. While marketing does not lack measures, it lacks standard measures and metrics explicitly linked to the financial performance of the firm in predictable ways. Standard metrics for assessing the outcome of marketing activities have the potential to facilitate and improve a variety of management decisions: (1) optimization of resources in such activities as media planning and design of the marketing mix, (2) forecasting, including both forward forecasting and the analysis of various "what if" scenarios, and (3) the assessment of financial return and return on investment.

In many areas, but not all, marketing also lacks formal processes for auditing marketing metrics models which tend to be highly idiosyncratic. It is important that outcomes arising from marketing activities be clearly identified with respect to their effects over time and the degree to which they may be common to all (or most) firms or are genuinely idiosyncratic to the individual firm. Those effects that are common across firms are candidates for a shared measurement standard.

Why Are Measurement Standards Important?

Measurement standards are essential to the efficient functioning of a marketing-driven company because decisions about the allocation of resources rely heavily on credible, valid, transparent, and understandable information. The availability of a generally accepted standard also relieves the individual firm of the costs of developing and maintaining its own unique internal standards.

Standards are so common that they are often taken for granted, but setting standards has never been easy. One major impediment to the development of standard metrics results from the competitive pressure of the market place. The view of some firms is that they may be able to achieve a competitive advantage through the use of a proprietary measurement tool that is better than metrics available to their competitors. This issue is not unique to marketing and has been played out in a broad array of contexts. Any potential competitive advantage gained from proprietary marketing metrics must not only be weighed against the costs of going it alone, but also against the opportunity costs associated with all of the other ways in which a firm could invest its resources. In such a scenario, executives of a firm that is very good at product development need to consider whether money that could be spent developing metrics would produce greater returns if it went instead into the development of additional products.

Absent a standard, whether broadly available or unique to an individual firm, there is no efficient means for assessing quality. If buyers cannot distinguish a high quality seller from low quality seller, or an effective and efficient marketer from an ineffective and inefficient marketer, the high quality merchant's costs cannot exceed those of the low quality jobber or the high quality seller will not survive. This is called adverse selection or the moral hazard problem in economics. This type of problem currently exists in the areas of "black box" marketing measurement, where consultancies and marketing organizations offer predictions on marketing activities without explaining how their metrics are linked to the bottom line or how they arrived at their conclusions.

Defining Relevant Metrics for Marketing Accountability

Although many firms continue to struggle with the development of standard metrics and processes that link marketing to the bottom line, solutions are close at hand. Marketing has a long history of paying attention to measurement and the creation of metrics. There is no shortage of outcome metrics in marketing and these metrics can be very useful when appropriately applied. The problem is that most of the metrics used to assess the outcomes of marketing activities are tactical and not directly relevant to the overall financial performance of the firm (Lehmann 2004). The link between traditional marketing metrics and the financial performance of the firm is seldom explicit (Rust, Ambler, Carpenter, Kumar, and Srivastava 2004). Srivastava and Reibstein (2005) note that "pressure is being placed on marketing to justify expenditures and to translate their measures into financial outcomes, which is the language used by the rest of the firm." (p. 85). To respond to such pressure marketing outcomes must be linked to the objectives of the firm (financial performance, growth) in the common language of the firm (financial performance, shareholder value) through a well-defined and standard process. This common language must provide a basis for making decisions about alternative actions. The logical candidate for such a common metric is cash flow. It is a common denominator measure that is consistent across markets, products, customers, and activities. Thus, cash flow both short term and over time is the ultimate metric to which every marketing activity should be causally linked through standard processes that link intermediate marketing outcomes to cash flow.

Every marketing activity leads to an intermediate marketing outcome, which ultimately drives cash flow. And the process of validating all intermediate marketing outcome metrics against short-term and/or long-term cash flow drivers is the only way to facilitate forecasting, optimal resource allocation and improvement. So, how might such validation occur?

What Role Does A "Marketing Metric Audit Protocol" Serve?

It is no longer acceptable for marketing to be viewed as a cost that lacks standard metrics and processes to drive continual improvement. Thus, every intermediate marketing outcome metric should be validated against short-term or long-term cash flow drivers and ultimately cash flow. This investment will facilitate forward forecasting and improvement, which should be the criteria for validation. The 4-step MMAP process (Exhibit I) will become to the marketing profession what GAAP and IFRS are to accounting and ISO is to operations.

Step 1: Identify Cash Flow Drivers

- There will be at least one source of cash and 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

- 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 (validity and causality audit).

Call To Action

It is now time for corporations to move from talk about marketing accountability to action. In 2004, a group of marketing professionals and academics came together to respond to mounting pressure from corporate boardrooms to achieve marketing accountability. Recognizing that without measurement standards accountability would never be fully realized, the founding members set their mission to "establish marketing measurement standards for continuous improvement in financial performance." The group is chaired by Dr. David W. Stewart, Robert E. Brooker Professor of Marketing in the Marshall School of Business at the University of Southern California and current members include marketing scientists from PepsiCo, Starcom MediaVest, VNU, Kraft, JD Power, The ARS Group (rsc), MSI, and the ARF.

This group has begun the development of "Marketing Accountability Measurement Standards," identified characteristics for sound marketing measurements and defined a Marketing Measurement Audit Protocol (MMAP) for connecting all marketing activities to the financial performance of the firm. The group has established a Marketing Accountability Standards Board that will also be recommending a common language /vocabulary for the marketing industry.

To learn more about becoming a charter member of Marketing Accountability Standards Board please contact:

- David Stewart (chair): david.stewart@marshall.usc.edu
- Mark Manalang (administrator): mark.manalang@marshall.usc.edu

About the Author: David W. Stewart, Ph.D. is the Robert E. Brooker Professor of Marketing in the Marshall School of Business at the University of Southern California. From 1999 to 2004 he served as Deputy Dean of the Marshall School. Dr. Stewart is the immediate past editor of the Journal of Marketing and has authored or co-authored more than 200 publications and seven books. His research has examined a wide range of issues including marketing strategy, the analysis of markets, consumer information search and decision making, effectiveness of marketing communications, and methodological approaches to the analysis of marketing data. His research and commentary are frequently featured in the business and popular press.

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Exhibit 1


Intermediate Marketing Outcome
Cash Flow Driver
Cash Flow
Cash Flow Driver
Intermediate Marketing Outcome
Intermediate Marketing Outcome
Marketing Activity
Measures and Metrics
Validation & Test
Business Model

Exhibit II

Marketing Accountability Standards Board

Recommendations for Return on Marketing Investment Standards

1. Marketing accountability metrics are inherently financial constructs. No measure or measurement system is complete without a specific link to financial performance.
2. Marketing accountability metrics should reflect the standard financial concepts of return, risk, the time value of money and the cost of capital.
3. Marketing accountability metrics should provide information for guiding future decisions and for predicting future economic outcomes as well as provide retrospective evidence of the impact of marketing actions.
4. Marketing accountability metrics should recognize both the immediate, short-term effects of marketing actions and longer-term outcomes, as well as the fact that short and long term effects need not be directionally consistent.
5. Marketing accountability metrics should recognize the difference in total return on investment and return on marginal return on investment.
6. Marketing accountability metrics should recognize that different products and markets produce different rates of return
7. Marketing accountability metrics should distinguish between measures of outcome and measures of effort.
8. Marketing accountability metrics should provide information that is meaningful and comparable across products, markets, and firms
9. Marketing accountability metrics should clearly identify the purpose, form and scope of measurement.
10. Marketing accountability metrics should be documented in sufficient detail to allow a knowledgeable user to assess their utility using generally accepted standards of measurement development and to make comparisons among alternative measures.
11. Marketing accountability metrics should be assessed relative to generally accepted standards of measurement development and validation.
12. Marketing accountability metrics *should be recognized as a necessary investment for assuring sound decision-making, accountability, continuous improvement, and transparency for all stakeholders.*