

Value of Marketing



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MASB Board Meeting
Chicago, March 2010

Outline

- What is Marketing?
- Focus on short-term performance measures
- Stock Market perspective
- Financial Markets Research in Marketing
 - Value-Relevance
 - Mis-Pricing
- Issues
 - Marketing Metrics
 - Methods
 - Marketing Accounting
- Consequences for Marketing Management

Note: This talk draws upon research of various colleagues and some of mine.

**The impact of marketing on
financial performance is
not well understood**

Overwhelming focus on short-term performance measures

□ Examples of Marketing Metrics

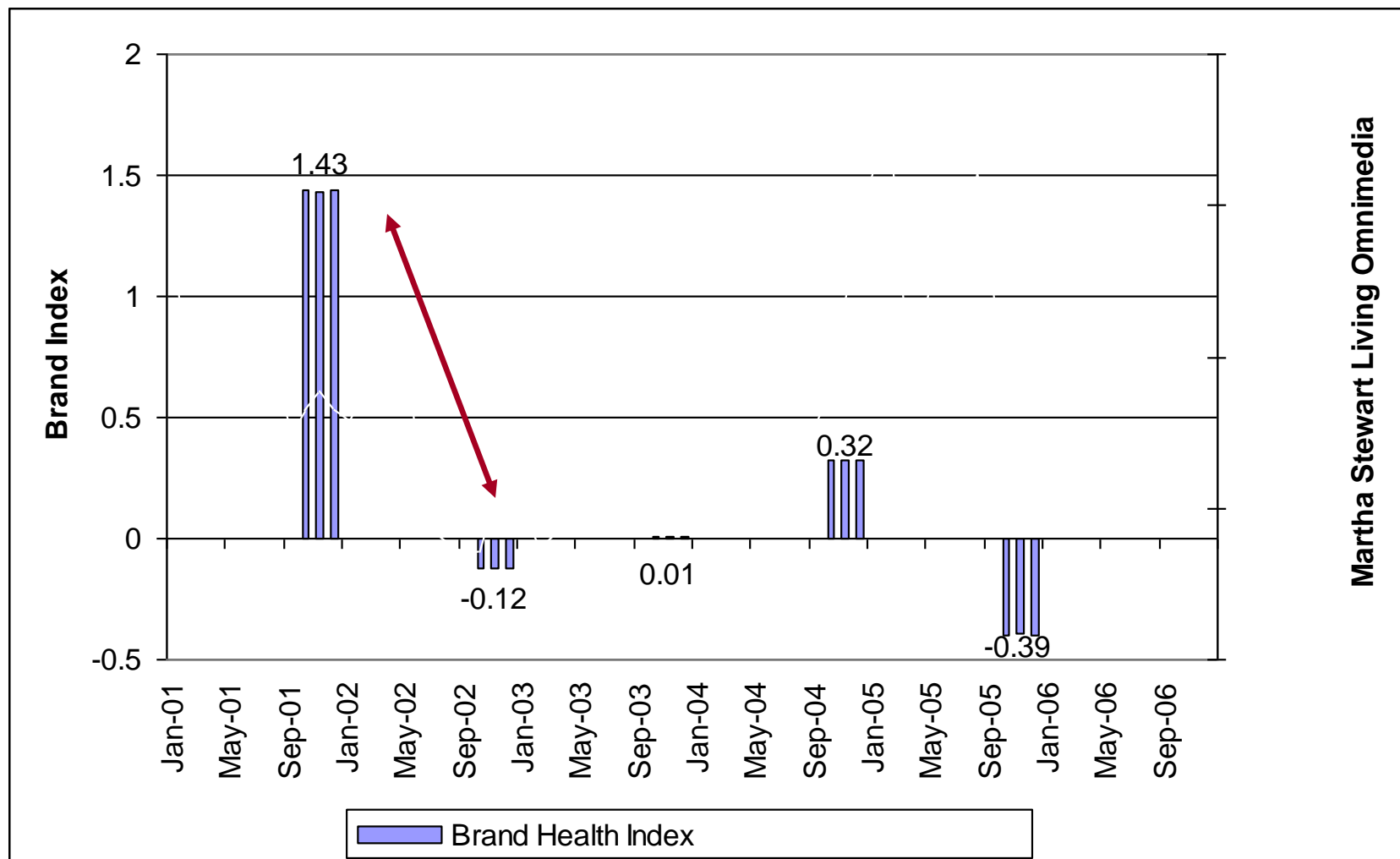
(“Marketing Metrics: The Definitive Guide to Measuring Marketing Performance”, Ferris, Bendle, Pfeifer, Reibstein, 2010;

Consumer (non-fin)	Hearts, Minds, & Market Share	Margins and Profits	Customer profitability	Marketing and Finance
<ul style="list-style-type: none"> ▪Familiarity ▪Attitude ▪Perceptions ▪Preference ▪Choice ▪Willingness to pay ▪Customer satisfaction 	<ul style="list-style-type: none"> ▪Market share ▪Relative market share ▪Market penetration ▪Willingness to search ▪Willingness to recommend 	<ul style="list-style-type: none"> ▪Unit margin ▪Margin (%) ▪Channel margins ▪Price ▪Mktg spend ▪Contribution per unit ▪Contribution margin (%) ▪Break-even sales 	<ul style="list-style-type: none"> ▪No. customers ▪Recency ▪Retention rate ▪Customer profit ▪CLTV ▪Prospect life time value ▪Average acquisition cost ▪Average retention cost 	<ul style="list-style-type: none"> ▪Net profit ▪ROS ▪ROI ▪Payback ▪Net present value (NPV) ▪Internal rate of return (IRR) ▪Return on mktg investment-ROMI

- **Lodish, Leonard M. and Carl F. Mela (2007), “If Brands are Built over Years, Why are They Managed over Quarters?”** *Harvard Business Review*, 85 (7/8): 104-112.

Martha Stewart Living Omnimedia, Inc.

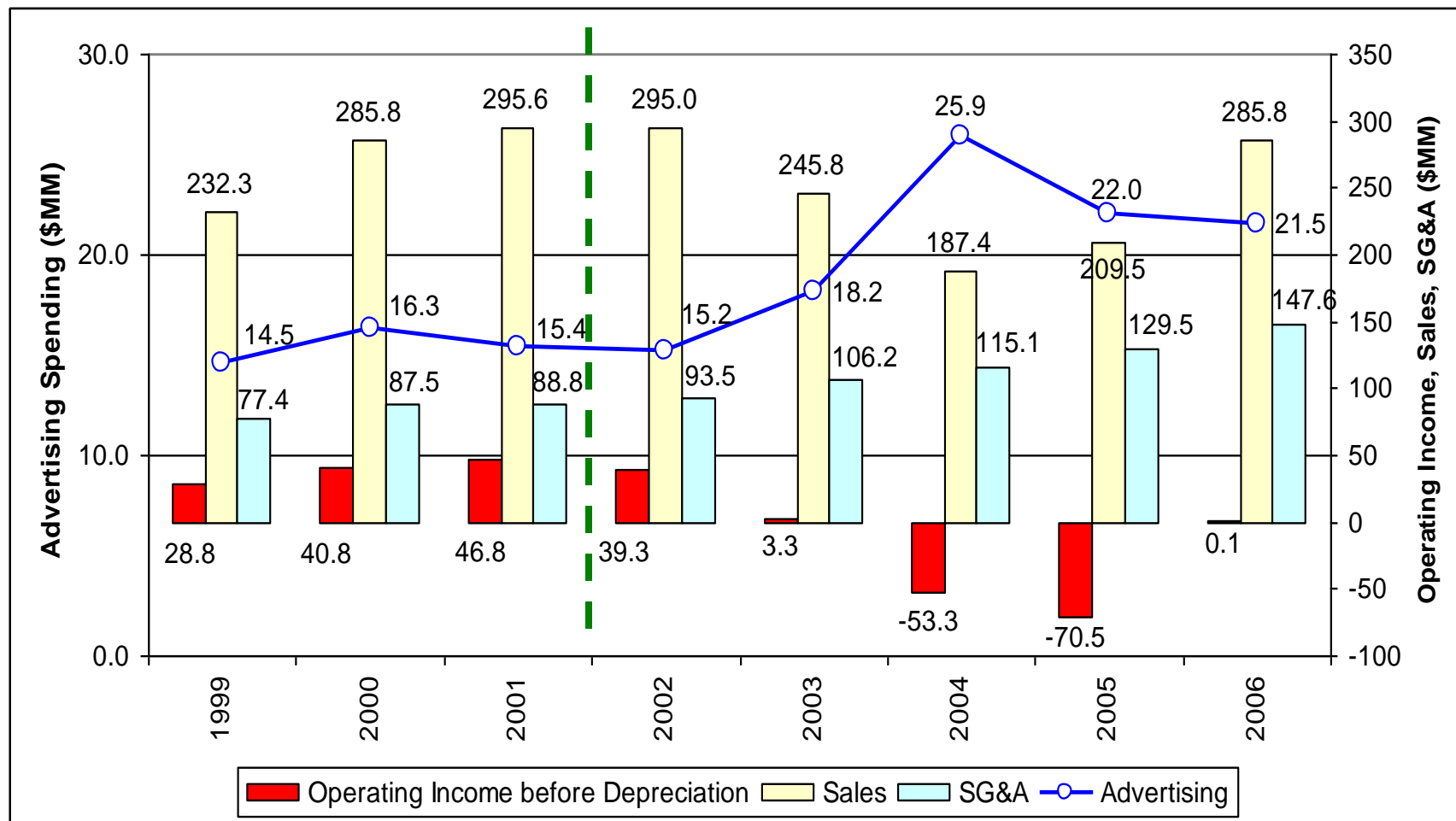
2002 ImClone Scandal



Source: Mizik N., "Assessing the Total Financial Performance Impact," *MSI # 09-116*

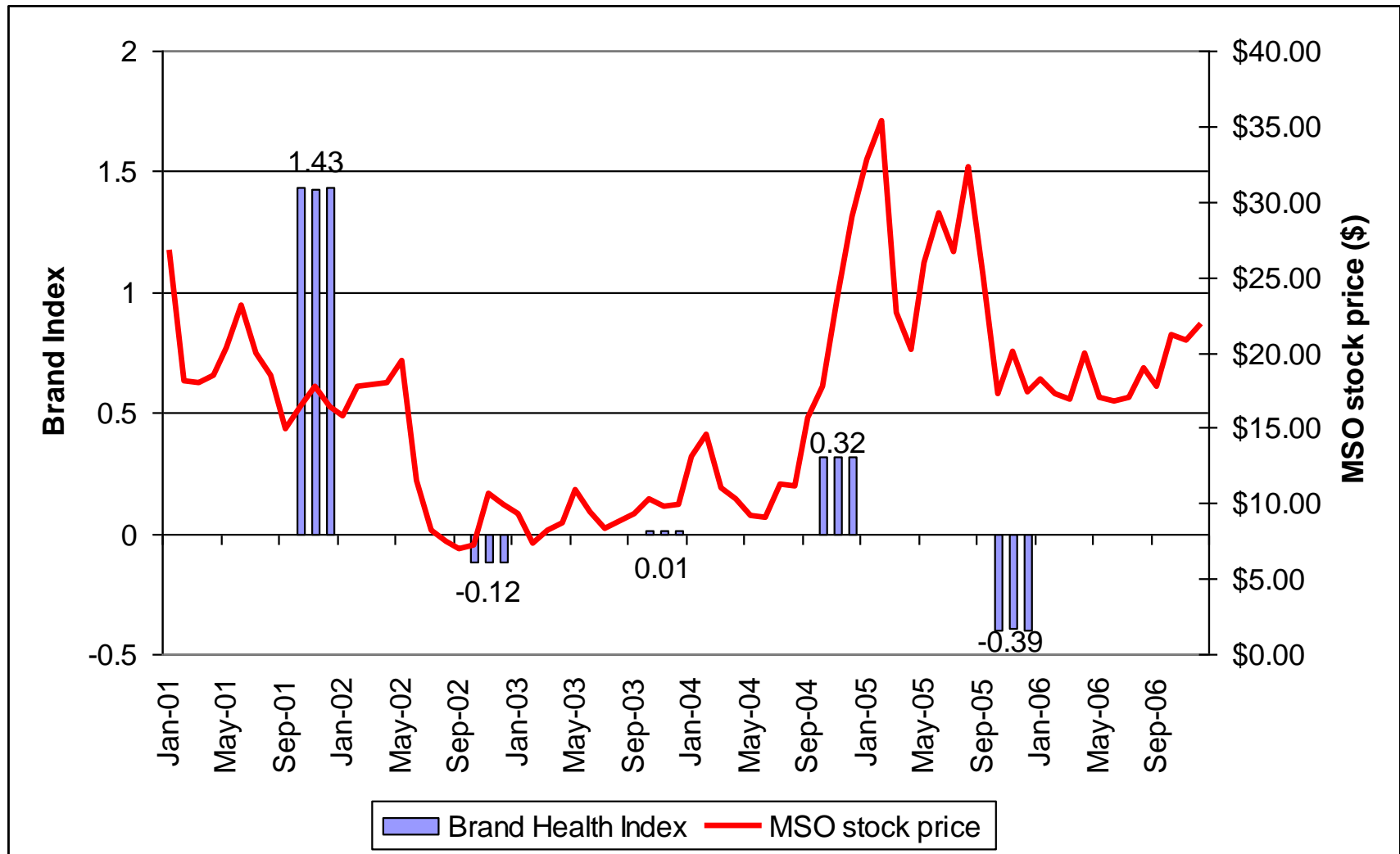
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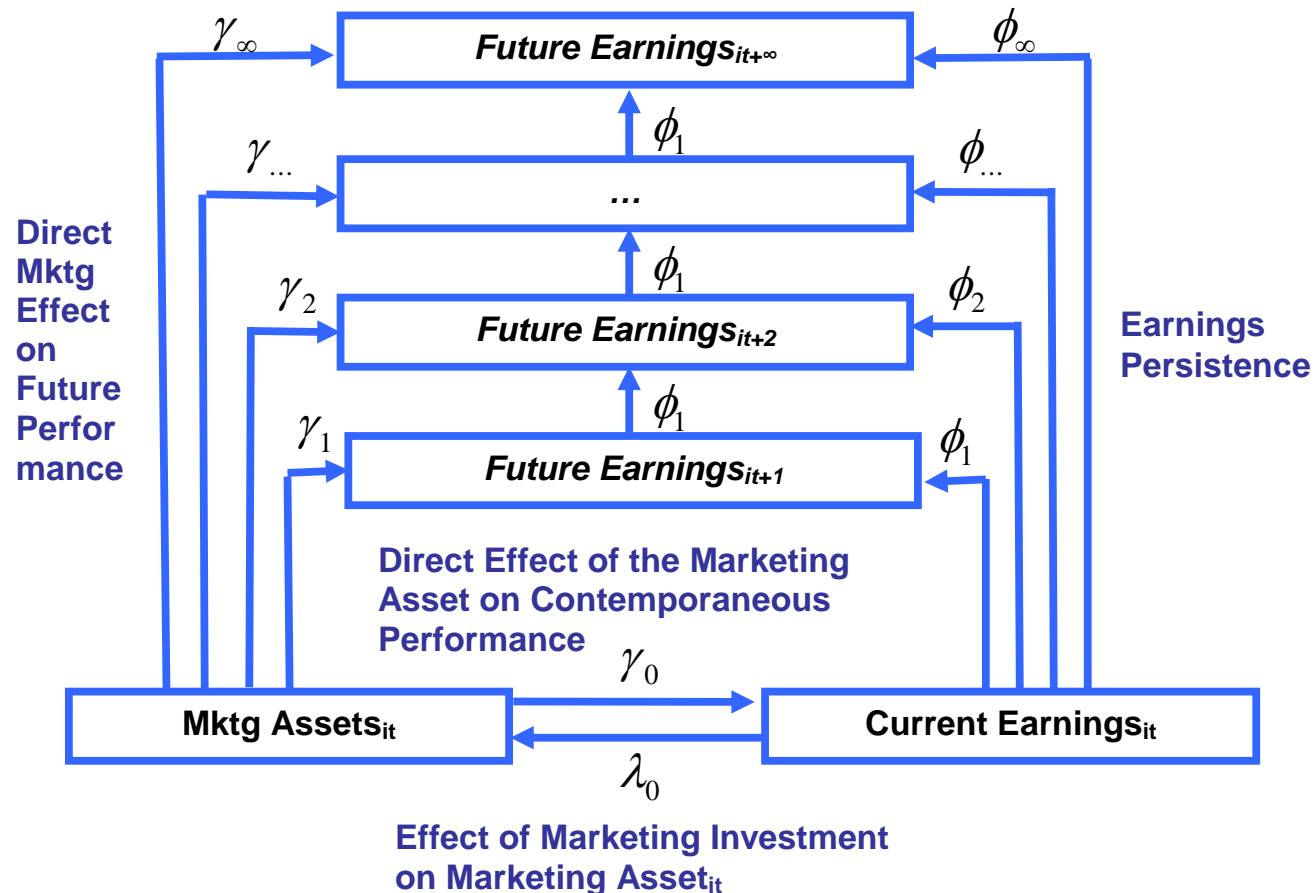
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Stock Market reaction can be used to ascertain total long-term impact

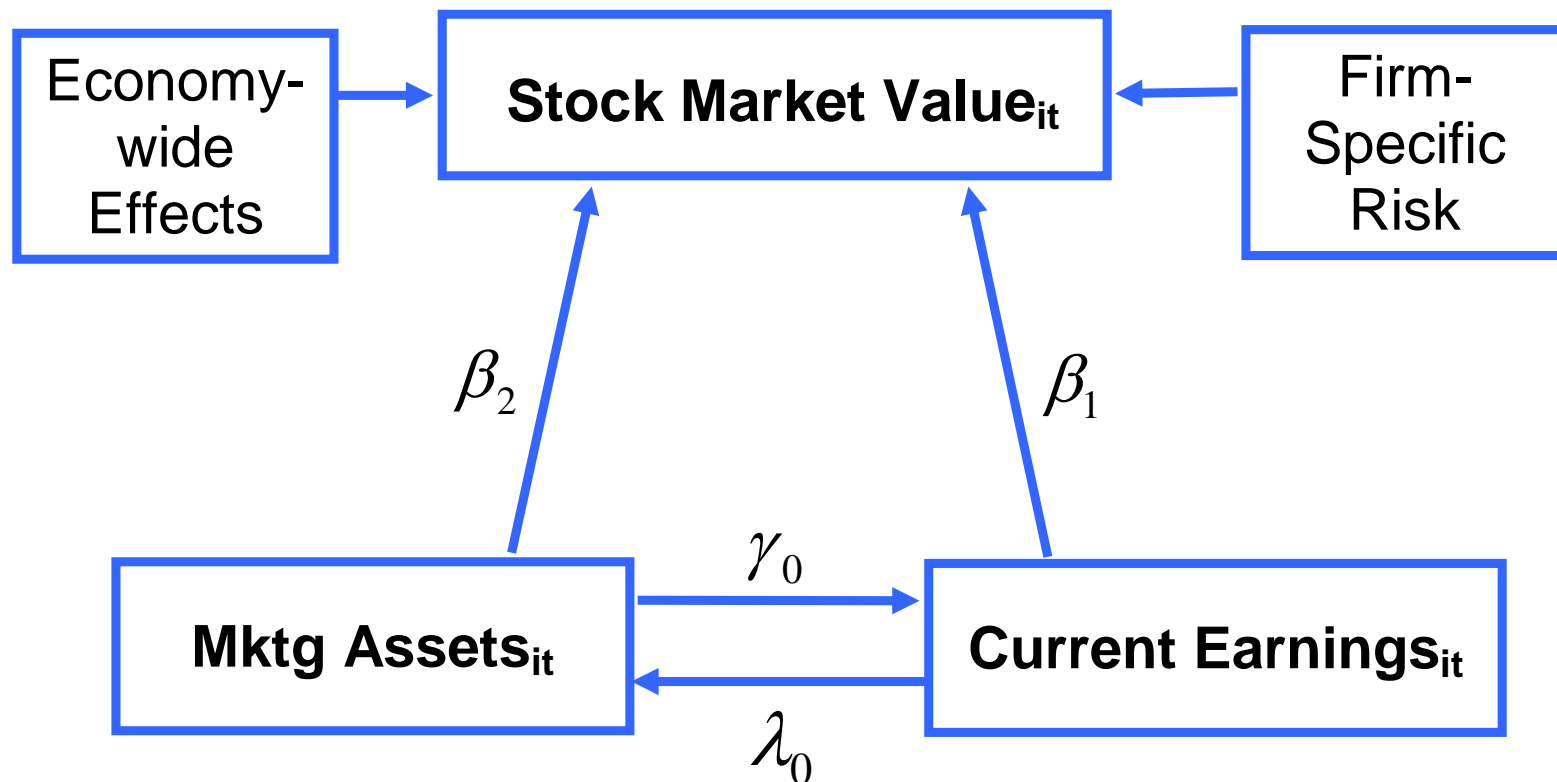
Figure 1. The Dynamic Performance Impact of Marketing Assets:
Stylized Theoretical Framework



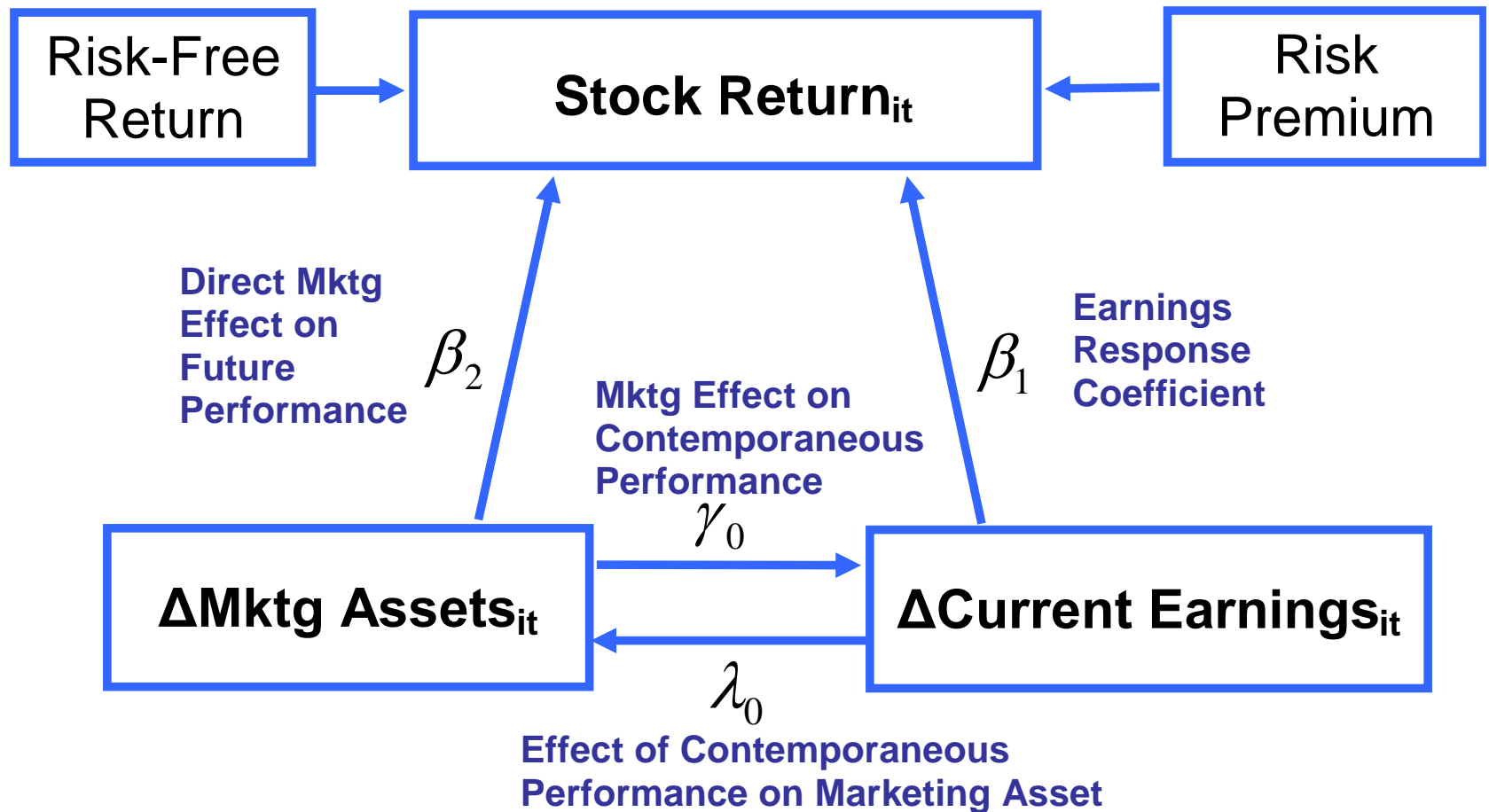
Source: Mizik N., "Assessing the Total Financial Performance Impact," *MSI # 09-116*

Stock Market reaction can be used to ascertain total long-term impact

Figure 2. The Dynamic Performance Impact of Marketing Assets:
Modeling Framework



**Figure 3. The Dynamic Performance Impact of Marketing Assets:
Estimation Framework**



Profitability Impact of Brands

- **Mizik N. (2009)**, “Assessing the Total Financial Performance Impact of Marketing Assets with Limited Time-series Data: A Method and an Application to Brand Equity Research” **MSI # 09-116**

~ **10%** of impact realized same-year

~ **90%** of impact realized in the future

Financial Markets Research (in Marketing):

1. Value-Relevance

(long-term performance consequences of mktg)

- **Event Studies**, short-window (celebrity endorsements, new product announcements)
- **Stock Return Response Models**, longer-window (for continuous measures of Mktg Asset)

2. Mis-Valuation

(mis-pricing anomalies, i.e., delays in market reaction to new value-relevant information)

- **Test** martingale process ($E(P_{t+1} | \Omega_t) = P_t$)

$$\text{StkR}_{it+k} = \text{Eret}_{it+k} + \sum_{j=1}^J \lambda(j) * \Omega_{jit} + \varepsilon_{it}$$

Issues

The impact of marketing on financial performance is not well understood

- Marketing Metrics
- Methods
- Marketing Accounting
(Performance Measures)

Issue 1 – Marketing Metrics

Challenges:

Mktg assets are often intangible and are difficult to measure

1. **Little consistency** in definitions and collected mktg metrics even within a single industry (Kimbrough and McAlister 2009).
2. Little standardized marketing metrics **data over time** (Pauwels, Currim et al. 2004)

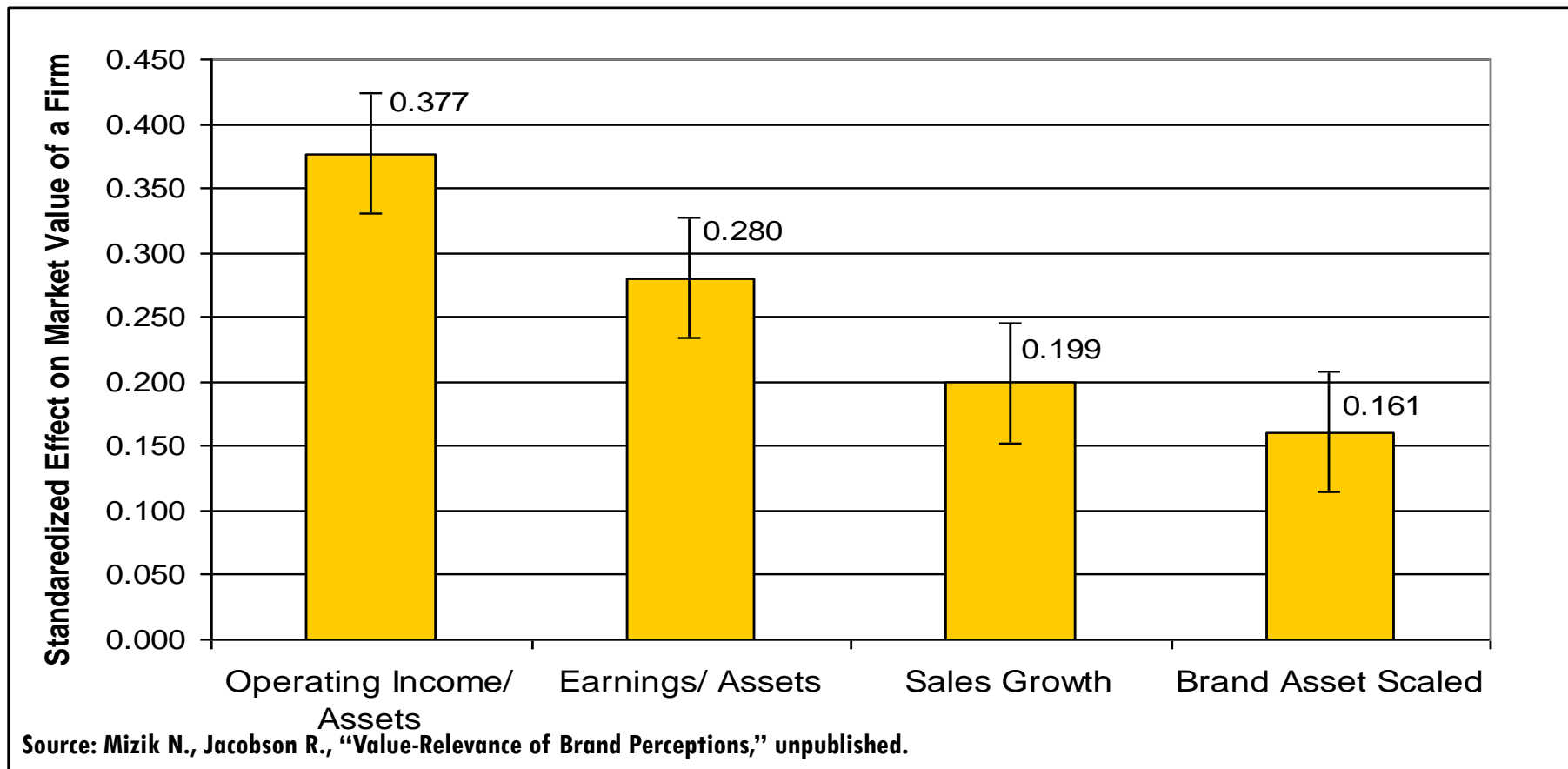
Poor data availability prevents the use of standard time series approaches for assessing the full dynamic impact of marketing

Because not all metrics are equally valuable:

- Research in marketing needs to focus on establishing the validity of marketing metrics and their incremental value in signaling future-term performance

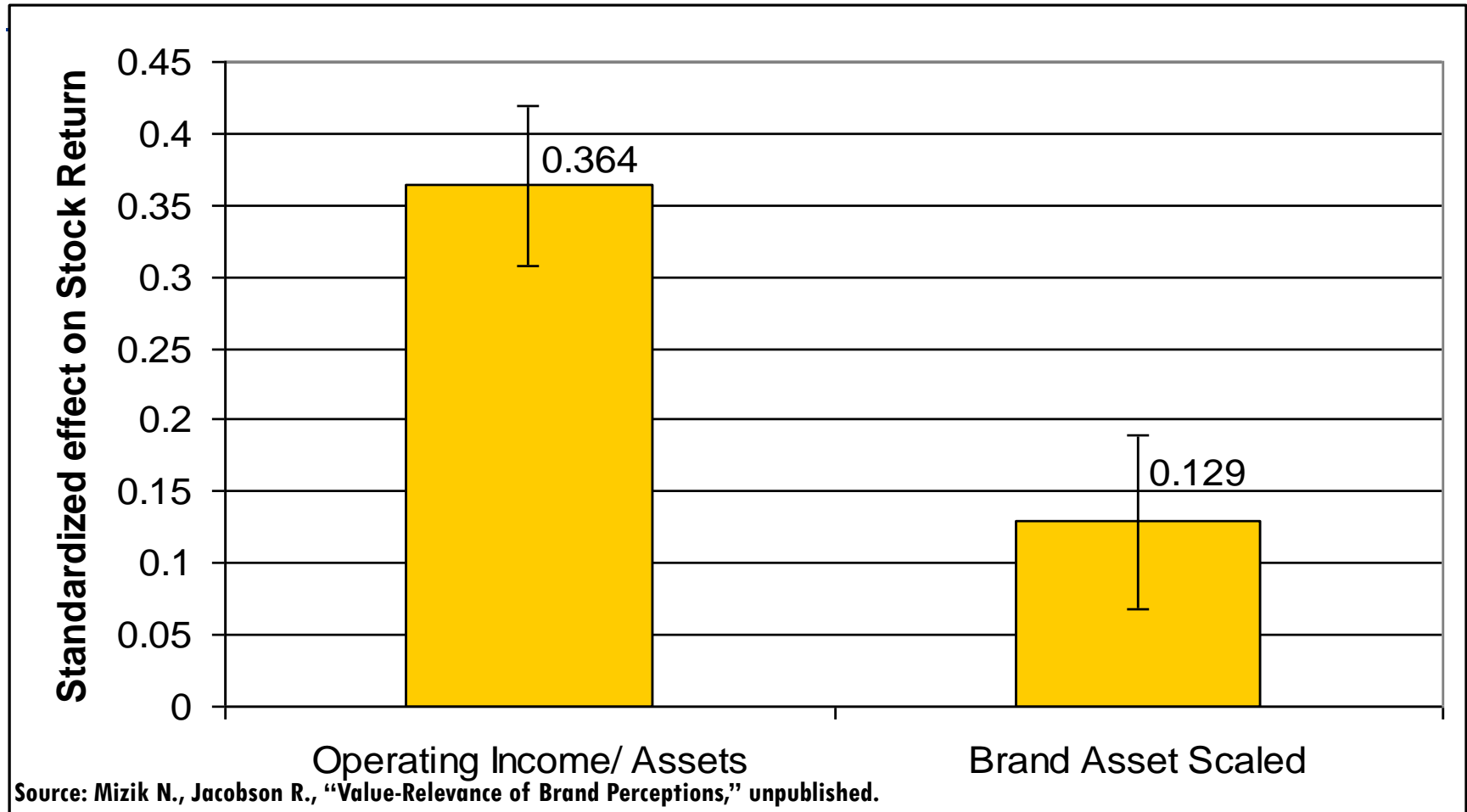
Holmstrom (1979): additional performance metrics are valuable if they provide incremental information to the existing set.

Total Impact of Contemporaneous Accounting Performance Measures and Brand Asset Index Measure on Stock Return of a Firm*



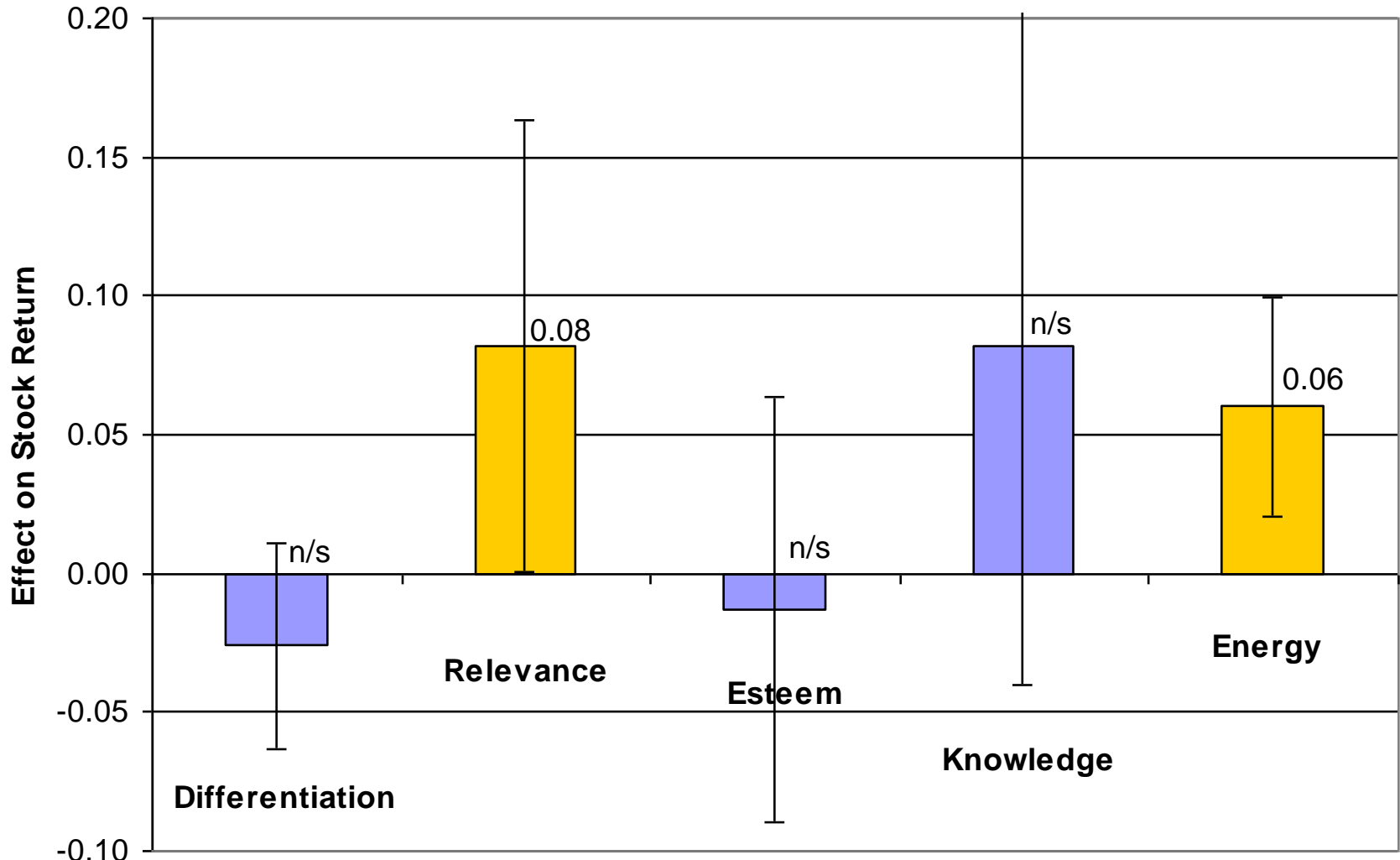
These results present the total impact for each individual measure if no other information is available. The numbers on the graph should be interpreted as follows: one standard deviation change in earnings leads to .28 standard deviation change in market value of a firm. Results presented are based on the models using continuously compounded stock returns, i.e., $\log(\text{ret})$.

Brand Asset Measure Contains Information Incremental to Earnings in Explaining Stock Return of a Firm*



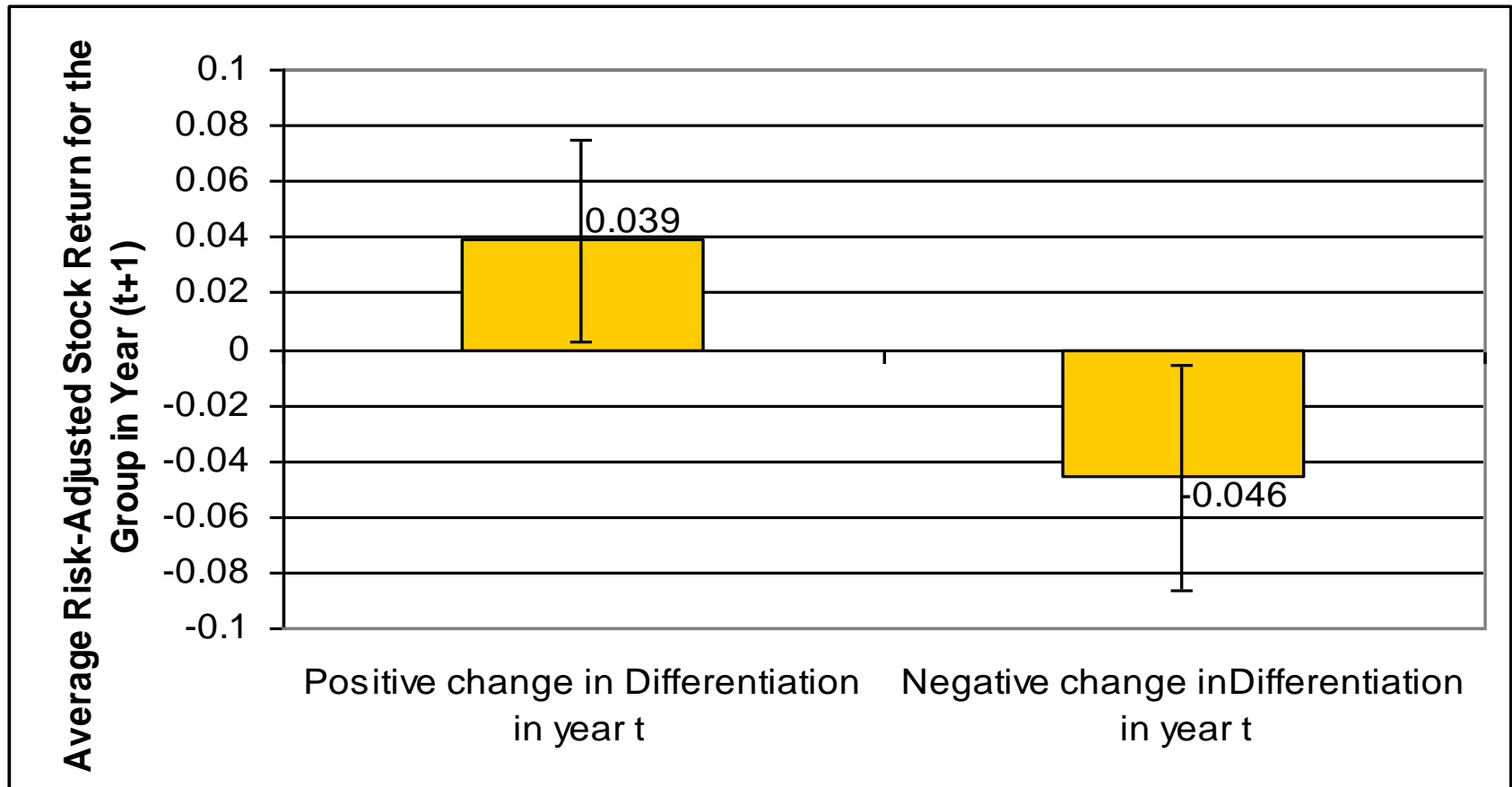
The numbers on the graph should be interpreted as follows: Brand Asset measure provides information about the future growth opportunities of the firm which is incremental to the information contained in Operating Income. Brand Asset can add additional 35% ($.129/.364$) of valuable information to Operating Income data in explaining stock returns. Results presented are based on the models using continuously compounded stock returns, i.e., $\log(\text{ret})$.

Incremental Impact of Individual Components of Brand Index



Source: Mizik N., Jacobson R., "The Financial Value Impact of Perceptual Brand Attributes," JMR, February 2008.

Differentiation Anomaly: Impact of Positive/Negative Change in Perceived Brand Differentiation on Stock Return the Following Year



Source: Mizik N., Jacobson R., "The Financial Value Impact of Perceptual Brand Attributes," JMR, February 2008.

Mizik N., Jacobson R., "Talk about Brand Strategy," HBR, October 2005.

Not all marketing metrics are valuable:

- Consumer **brand perceptions** (Y&R BAV) have incremental value to Earnings

- Customer Satisfaction (**ASCI**) has **NO incremental value to Earnings and NO mis-pricing**

Sources: Jacobson R., Mizik N., "The Financial Markets and Customer Satisfaction: Re-examining Possible Financial Market Mis-Pricing of Customer Satisfaction," *Marketing Science*, 28 (5), 809-818.

Source: Ittner, C., D. Larcker, D. Taylor., "The stock market's pricing of customer satisfaction," *Marketing Science*, 28(5) 826-835.

Jacobson R., Mizik N., "Value-Relevance of Customer Satisfaction," unpublished manuscript.

Issue 2 – Methods

- New Research area in marketing
- Little knowledge and experience with the methods and theory

Brand Valuation

There are three main brand consultancies producing annual brand rankings:

Interbrand “Best Global Brands”

Published in *Business Week* in September

Millward Brown “Top 100 Lists”

Published in the Financial Times in April

Brand Finance “The World’s 500 Most Valuable Brands”

Published on their website in April

**Interbrand and Millward Brown use the earnings split approach;
Brand Finance uses relief from royalty**



Highly Divergent Estimates of Brand Value

Brand	IB BV 09	Brand	MB BV 09	Brand	BF BV 09
Coca-Cola	68,734	Google	100,039	Wal-Mart	40,616
IBM	60,211	Microsoft	76,249	Coca-Cola	32,728
Microsoft	56,647	Coca-Cola	67,625	IBM	31,530
GE	47,777	IBM	66,622	Microsoft	30,882
Nokia	34,864	McDonald's	66,575	Google	29,261
McDonald's	32,275	Apple	63,113	GE	26,654
Google	31,980	China Mobile	61,283	HSBC	25,364
Toyota	31,330	GE	59,793	Vodafone	24,647
Intel	30,636	Vodafone	53,727	Hewlett-Packard	23,837
Disney	28,447	Marlboro	49,460	Toyota	21,995
Hewlett-Packard	24,096	Wal-Mart	41,803	Bank of America	21,017
Mercedes	23,867	ICBC	38,056	McDonald's	20,003
Gillette	22,841	Nokia	35,163	Nokia	19,889
Cisco Systems	22,030	Toyota	29,907	AT&T	19,850
BMW	21,671	UPS	27,842	Verizon Wireless	18,854
Louis Vuitton	21,120	Blackberry	27,478	China Mobile	17,196
Marlboro	19,010	Hewlett-Packard	26,745	Orange	16,799
Honda	17,803	BMW	23,948	Disney	16,750
Samsung	17,518	SAP	23,615	Budweiser	16,692
Apple	15,443	Disney	23,110	Tesco	16,408

Source: Type 2 Consulting

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Natalie Mizik "Valuing Marketing"

No Agreement on the Direction of Change

Brand	09 vs 08 I'BRAND	09 vs 08 M BROWN	09 vs 08 B FINANCE	Sign change consistent?
Coca-Cola	3%	16%	-28%	NO
Microsoft	-4%	8%	-31%	NO
Google	25%	16%	-32%	NO
IBM	2%	20%	-17%	NO
GE	-10%	-16%	-26%	YES
McDonald's	4%	34%	-8%	NO
Apple	13%	14%	-37%	NO
Nokia	-3%	-20%	-40%	YES
Toyota	-8%	-15%	-16%	YES
Hewlett-Packard	2%	-9%	-30%	NO
Disney	-3%	-3%	-15%	YES
Intel	-2%	4%	-45%	NO
BMW	-7%	-15%	-21%	YES
HSBC	-20%	3%	-28%	NO
Gillette	3%	6%	-75%	NO
UPS	-8%	18%	-20%	NO
Cisco Systems	3%	-25%	-40%	NO
Mercedes	-7%	-14%	-51%	YES
Oracle	-1%	-6%	17%	NO
Pepsi	3%	-3%	-38%	NO

Issue 3 – Accounting Distortions

- Current financial reporting practices
 - distort both financial inputs and outputs of mktg activities
 - lead to difficulty in estimating contributions
 - lead to managerial neglect
 - facilitate myopic management
- Marketers do not understand these distortions

**Assets that are not properly Measured
can not be properly Managed**

Source: Mizik N. and D. Nissim, “Financial Reporting and Accounting for Marketing Activities: Implications”

Accounting Treatment of Marketing Activities and Assets

- **Internally developed** intangible mktg assets are not recognized on the balance sheet, marketing costs are expensed as incurred. As a result:
 - Reported income, assets, book value are distorted, Tobin's Q not valid
 - The value of internally generated (organic) assets is unrecognized and unappreciated by internal constituency, which can lead to neglect
 - Effectiveness of mktg activities in generating valuable intangible assets is difficult to assess, which can lead to mis-guided budgeting
 - Creates conditions for senior management to engage in Myopic Marketing Management
- **Acquired intangible assets** are recognized on the balance sheet, but the negative implications are not mitigated

Balance sheet recognition of mktg assets is not a solution

Source: Mizik N. and D. Nissim, "Financial Reporting and Accounting for Marketing Activities: Implications for Marketing Research and Practice," unpublished manuscript

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Consequences for Marketing Practice

Lack of reliable metrics to track spending and evaluate effectiveness of marketing activities reinforces these behaviors.

Two sides of organizational conflict:

■ **Myopic Management at the top**

- cutting marketing and R&D investments to meet short-term performance goals
- price discounting and channel stuffing
- delaying new projects

■ **Gaming by Marketing Managers**

- marketing budget padding **- 86%**
- blow-it-all spending of marketing budgets **- 80%**

**Libby, Lindsay
(2007) survey:**

Waste of company resources and the resulting resource mis-allocation is detrimental to the organizational performance and to investors.

Source: Mizik N. and D. Nissim, "Financial Reporting and Accounting for Marketing Activities: Implications for Marketing Research and Practice" unpub. Mizik, Natalie and Robert L. Jacobson (2007) "Myopic Marketing Management," *Marketing Science*, 26 (3), 361-379.

Summary:

- What is known?

very little (Srinivasan and Hanssens, JMR2009)

- What needs to be done?

- standardization of marketing metrics
- improvements to financial reporting of marketing activities (accounting practices)
- education on research methods
- research to establish long-term effects of mktg
- research to identify valuable Marketing Metrics, i.e., metrics with ***incremental*** value to existing set

thank you
