The CMO’s Perspective

MJ Cummings

August 16, 2007

THE BOARDROOM PROJECT

ANA Marketing Accountability Findings

"…increasingly there is the belief that marketing is the lever that drives revenue and we need to apply the same level of vigor and insight to the financial decisions in marketing as we do in any other area…" Jim Garrity, CMO Wachovia

"Marketing is a $450BB industry and we are making decisions with less data and discipline than we apply to $100,000 decisions in other aspects of our business" Jim Stengel, CMO P&G

CMO Concerns: ANA Survey

- The number one issue on senior Marketer's minds three years and running
- What senior marketers told ANA they worry about
  - How to measure marketing effectiveness,
  - How to translate less quantitative metrics, e.g. brand strength, into business drivers
  - How to build long term brand equity within Wall Street's short term focus
  - When will ROI tools catch up with marketing tactics
  - Building ROI metrics into campaigns at the planning stages rather than trying to figure out how to measure effectiveness after the fact.
  - Predictive marketing measurements

CMO Concerns cont.

- Going beyond ROI to linking Marketing impact to company margins
- The issue on what is the key metric for marketing continues.
- A focus on profitability often leads to short term decisions that hurt the company in the long run. A focus on cash flow seems to be the same thing.
- Image or awareness metrics don't seem sufficiently linked to spending and don't have predictive trends. What are the key measurements?
- The linkage of brand building to sales success. Ways to use brand health as a competitive advantage

ANA Member Accountability Status

- Three years of ANA accountability surveys
  - Concerns about data reliability, alignment among disparate sources and timeliness
  - Only 4% were confident they could act quickly in response to ROI data to improve results
  - Only 3% felt they could improve the quality of the company’s planning process

2007 Report of ANA's MATF

- Marketing & Finance realizing success depends on collaboration
- But data continues to be a real challenge
  - Accuracy of syndicated data
  - Timely availability of data
  - Alignment between disparate sources
- 25% have or are rolling out Dashboards
  - Not in time to change/manage program/results
  - No analytical protocol for discovering causes of failures
- Few companies have marketing process to manage/improve ROI
  - Process remains an unfamiliar concept
  - Potentially threatening

More Horrors for CMOs

- “A study to be published in the Journal of Marketing that covered 167 companies including Procter & Gamble, Microsoft and Apple over a five-year period concludes that CMOs on top management teams don't have any effect on a company's financial performance.”
- “Among the companies studied, less than half, 40%, had CMOs in their top-management teams. As a comparison, 97.2% of the firms in the study had a CFO in that team.”
- "Financial metrics alone do not define CMO performance," "universal panacea to making marketing accountable doesn't exist.“ – Andrew Tipping, Booze Allen Hamilton
- “At least CMOs don't do harm: "It is important to note that CMOs do not have a negative impact on performance," the study found.”

CMOs Rapped for Having Zero Impact on Sales, Advertising Age, July 9, 2007

Current Situation – from ANA

- Hard to define Marketing return on investment
- Ill defined process
- Little connection between Marketing spending and increasing Brand Equity, the principal function of marketing.
- Sometimes an emphasis on inputs (CPM or redemption rates) not outputs
- Often little connection between Marketing spending and increasing Brand Equity, the principal function of marketing.
- Marketing bears the responsibility of driving the top line through innovation and revenue growth.
- It has the responsibility to improve gross margin by creating stronger brand equity for which consumers will pay a premium.
- And it may be the source of additional savings by identifying and eliminating that "half" of marketing spending that some have traditionally claimed is wasted.

Thank you!

THE BOARDROOM PROJECT

A value based marketing model

MJ Cummings - SSG **June 2006**

Cost vs. value

Cost (kôst) *n.* An amount paid or required in payment for a purchase; a price.

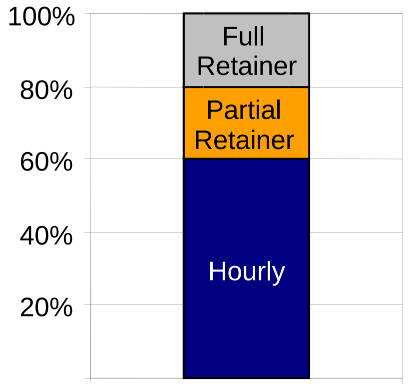
Value (v l y) *n.* Worth in usefulness or importance to the possessor; utility or merit:

- Our current method of agency valuation is antiquated if not broken.
- There is no connection between the marketing budget and actual value to Visa (ROI).

Current payment model

- Visa currently pays most marketing communications agencies based on an hourly wage with advertising agencies working on a service based retainer
- Value of agencies is determined subjectively, through internal surveys and by the business units' general perception of the quality of agency work

Core Agency Compensation %



Currently none of Visa's agencies are compensated using a quantifiable performance model.

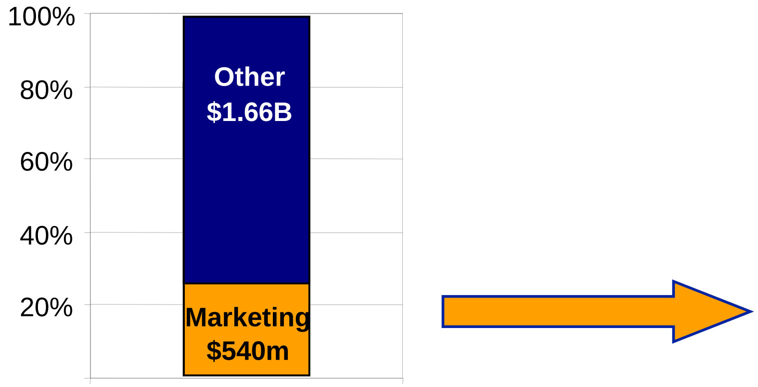
Current budgeting model

- While Visa is moving toward a zero based budgeting model, historically budgets have been determined by the previous year's budgetary needs
- A marketing plan is the only tool the cost center manager has to fight for budget
- A traditional marketing plan does not tie efforts to the bottom line - it can't "speak" to the finance department

The CFO's perspective

- Marketing departments are cost centers
- The marketing plan doesn't include quantifiable measures
- What will happen to my money? Is there any real value in these marketing efforts?
- Marketing is a pure expense - it subtracts from my bottom line

Total Operating Expenses of $2.2B



Nearly 25% of all FY05 expenses were Advertising, Marketing and Promotion

Source: FY05 Annual Report

How about this scenario…

- J. : “We need to increase new small business customer acquisition for our members by 12% over FY 07.”
- K. : “My studies indicate that, all other things being held equal, for each dollar spent in our current marketing mix, X new customers are acquired. We will need $Y to reach this goal.”

Or this one…

- K. : “In FY 07 my department was directly responsible for an addition of $X to Visa’s bottom line through an increase of transaction volume by Y.”

Align marketing and corporate strategy

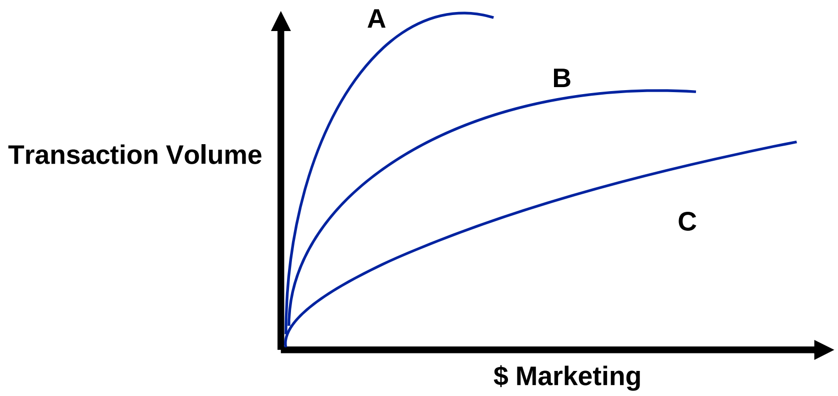
- Marketing spending and mix should reflect quantifiable growth objectives
  - Spend should **not** be based on past spend, funds available or competitive norms
- Utilize valuation and optimization of marketing expenditures
  - Have a quantifiable measure of the impact of communications efforts
  - Use proven economic principles of resource allocation to guide spending decisions

Enter marketing science

- What is it?
  - Untangling market factors to determine the true drivers of value
  - Multivariate regression to determine causation coupled with linear programming to perform optimization.
- Who’s doing it?
  - Wachovia, Wells Fargo, Capital One, MBNA, MasterCard
  - P&G, Kraft, Clorox, Unilever
- What can we do with it?
  - Determine elasticities to inform budget, mix and value
  - Offer analytics services and prove program value to members

Marketing elasticity

- The extent to which a marketing program affects a given variable (revenue, volume, acquisition)
- Elasticity can guide the budgeting process
- It can also inform the pay-for-value model



Elasticity is a change in "benefit" (in this case transaction volume) from a change in the independent variable (in this case marketing spend).

- Just a small dollar change in initiative A triggers a significant increase in transaction volume. C does not. C is inelastic.

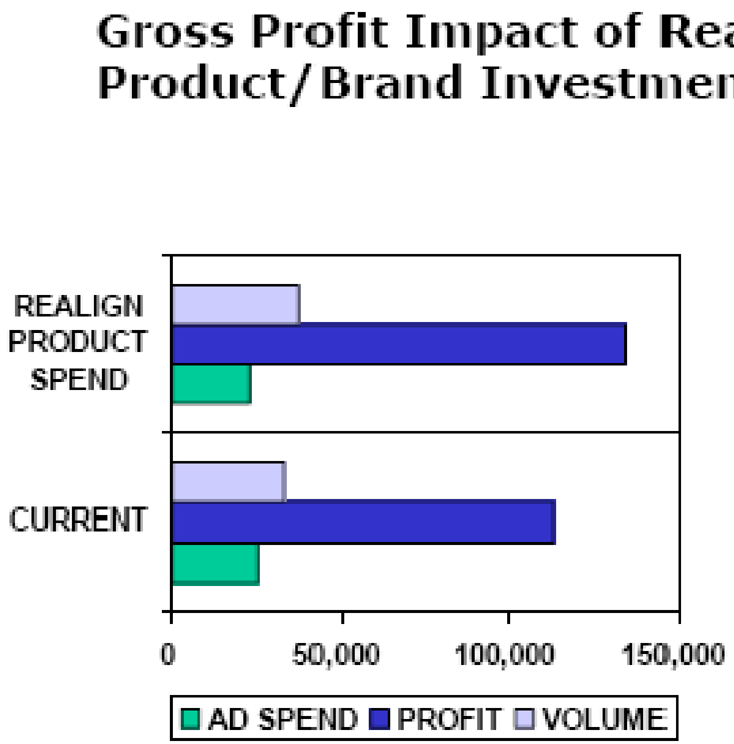
Marketing mix optimization

Question: I have $60M to spend on three marketing initiatives. Given the proven elasticity of each of these initiatives and given the combined effects they may or may not have on each other, what is my ideal mix?

Elasticity of initiative	Mix	Spend
0.04	21.05%	$12.6
0.06	31.58%	$18.9
0.09	47.37%	$28.4
Totals:		
0.12	100.00%	$60.0

Optimization a.k.a. linear programming (LP) or mathematical programming (MP) is commonly used in resource allocation, logistics and portfolio planning.

A successful optimization effort



Rule: *Optimize investment by product*

Gain 12% in Unit Sales

Gain 19% in Profits

**Source: Market Share Partners*

A minor change in spend created an significant upward adjustment in volume and profit.

Successful prediction of results

8 Months Later – The Model Worked

Model Validation R2 = .96

**Source: Market Share Partners*

The R Squared value (above) is a measure of the relative predictive value of a model. This one has an error of just 0.04.

Immediate benefits of the ROI model

- The marketing department is no longer a cost center but a revenue center (or finally proven as such)
- Marketing can talk to finance
- Elasticity can inform value based pay models
- Basing budgets on elasticity inherently rewards agencies for effective work
- Budgeting is less painful
- Marketing can justify its spend and quantify its successes
- **Marketing is safer in an age of compliance scandals and an increasing focus on fiscal responsibility**

A scary scenario – Basel II and SOX

- European compliance standard for banks implemented in Fall of 2005
- Banks are held accountable for all levels of risk including asset risk (cash)
- Banks may have to prove ROI of all marketing efforts
- When will SOX-like compliance issues hit marketing?
- The CMO is the last man standing without justification of spend

Common Financial Analysis

- Financial analysts study ratios to determine a company's value
  - Debt ratios, Liquidity ratios, Asset Turnover, Inventory Turnover, Liabilities etc…
- Purpose is to determine health and intelligence of a business
- Consider the size of Visa's marketing budget - $300M spent March 05 to March 06 (20% of Visa's operating budget)
  - When will investors and analysts start wanting to know the value of these large expenditures?
  - When will marketing ROI be a standard line item on year-end financial reports?

Next Steps

Timing

…5 months from sourcing a consultant to training on tool…

- Attain Business Unit buy in
- Locate expert consulting firm (4 weeks)
- Form steering committee (2 weeks)
  - SSG, Analytics, Marketing, Advertising and Outside Consultants
- Determine measures to be studied (2 weeks)
  - Volume, acquisition, retention, channel influences, etc.

Next Steps

Timing

…5 months from sourcing a consultant to training on tool…

- Gather data (4-6 weeks)
  - from VMC, VIN, analytics team, agencies, Innovant etc.
- Model data (2-3 weeks)
- Customize optimization tool (2 weeks)
- Train user(s) on tool (1 week)
  - Visa team member(s) assigned to an analytics team
- Begin test program (Southeast region – Q3 2007)

Interim steps FY 07

- Develop a culture of value amongst marketing group and agencies
- Pilot a program that will enable migration to a value based pay system (with an admittedly inexact value determinant)
- Continue to cull agency numbers
- Request that agencies begin reporting ROI where possible
  - Direct and online are good places to start

Questions?