The Role of Standards

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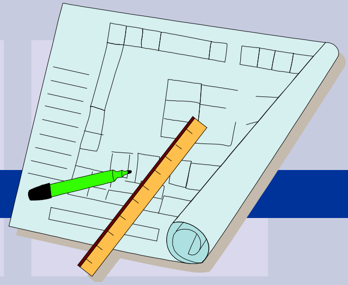
Framing the Problem

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

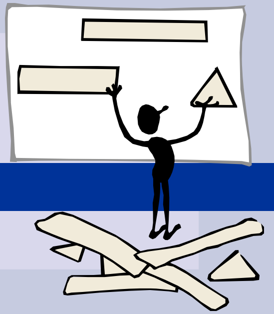
The quality movement has spent 50 years proving itself

- 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

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.

Alternative Solutions to the Problem:

- Government Intervention
- Self-government w/standards setting body
- Default: Render unimportant & control costs

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)**

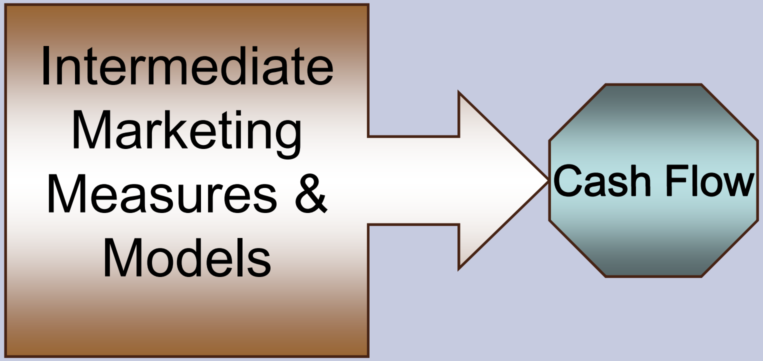
Three Types of Return on Marketing Investment

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**



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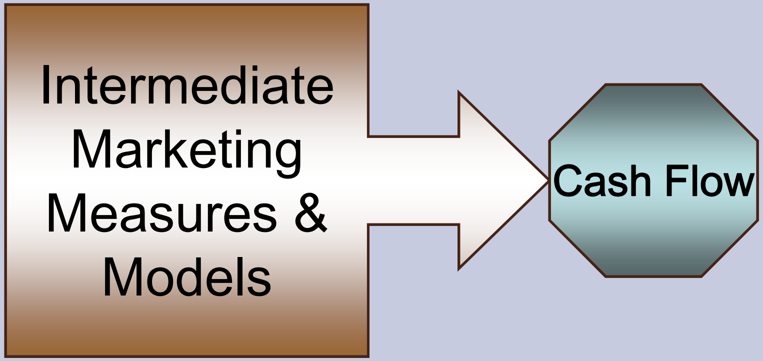
Long-Term (Baseline) Impact

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



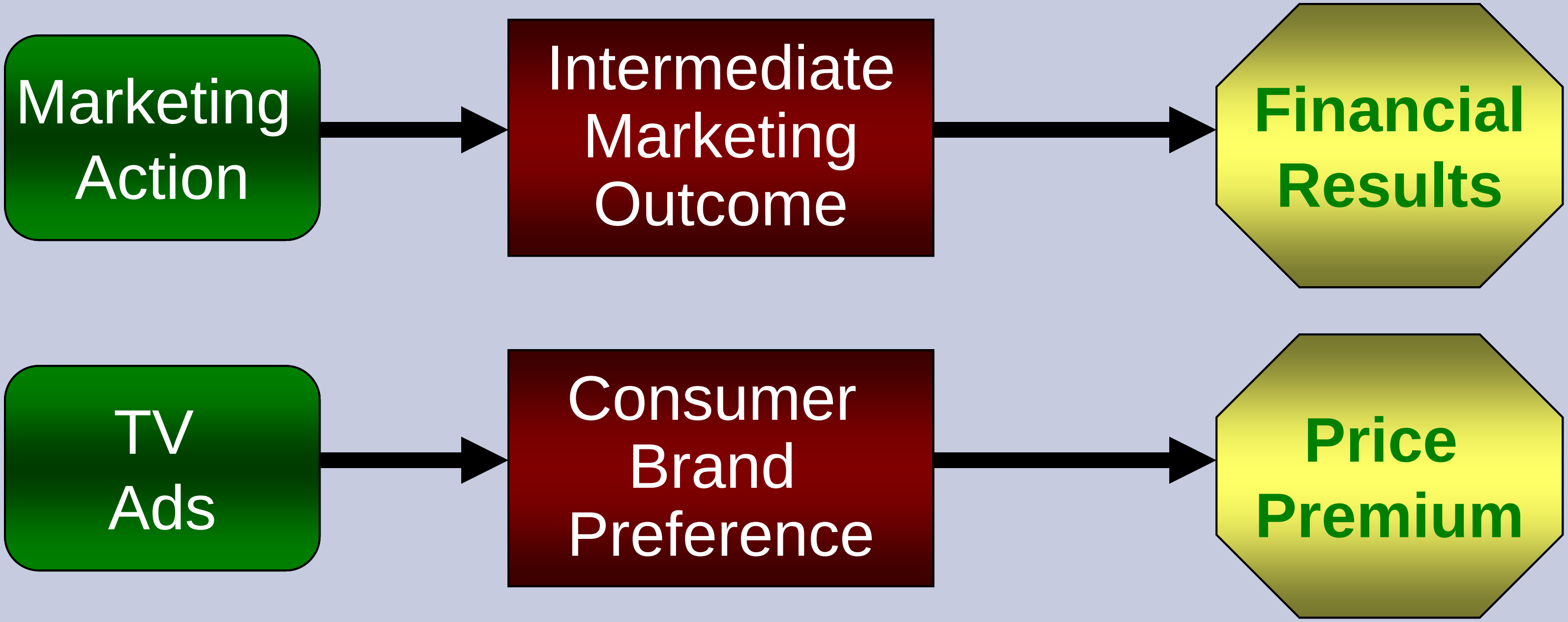
Real Options

- **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)

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



Marketing Metric Audit Protocol (MMAP)

A formal process to:

- Identify the drivers of cash flow
- Link marketing activities to marketing metrics
- Link marketing metrics to drivers of cash flow
- Identify causal links & test assumptions

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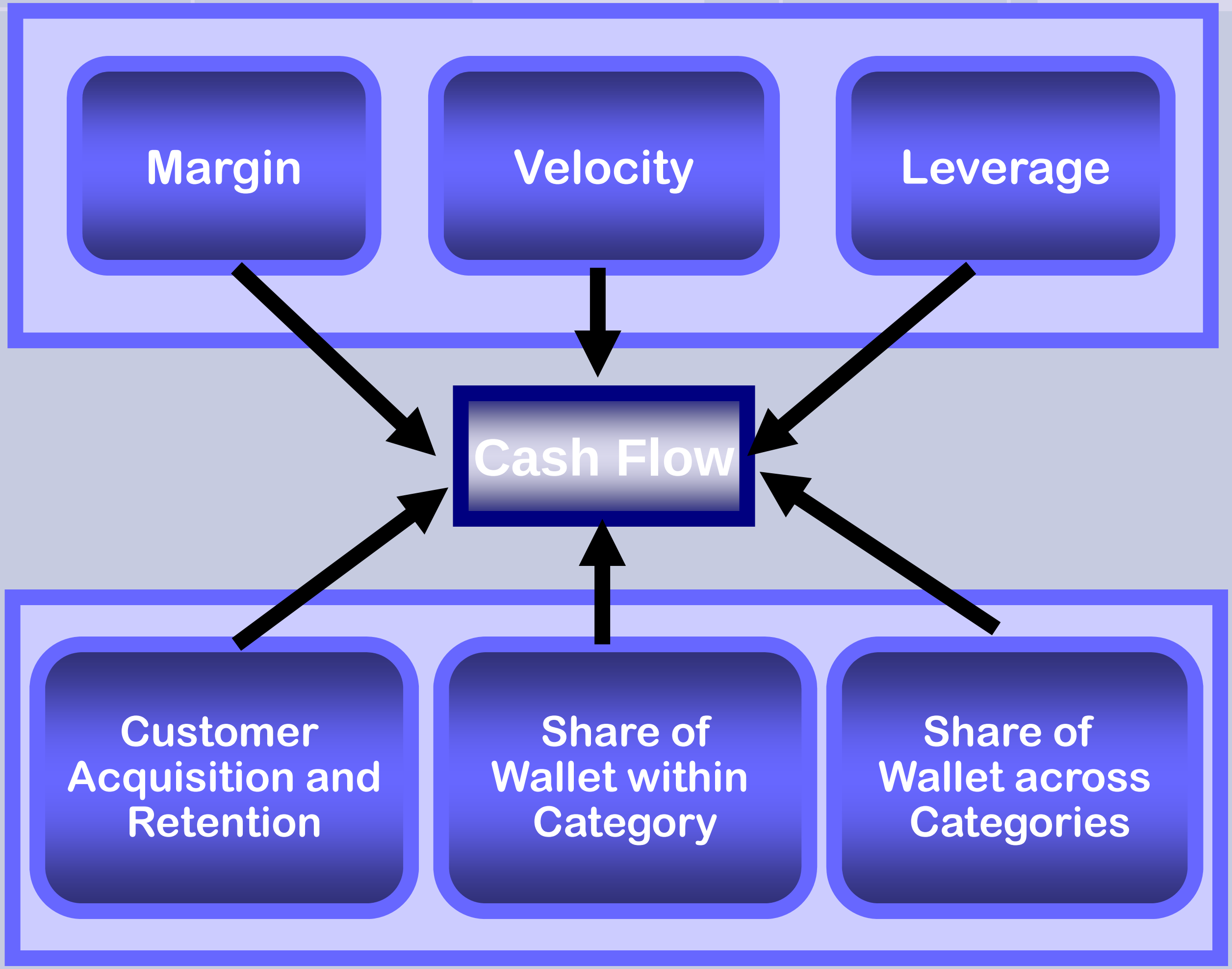
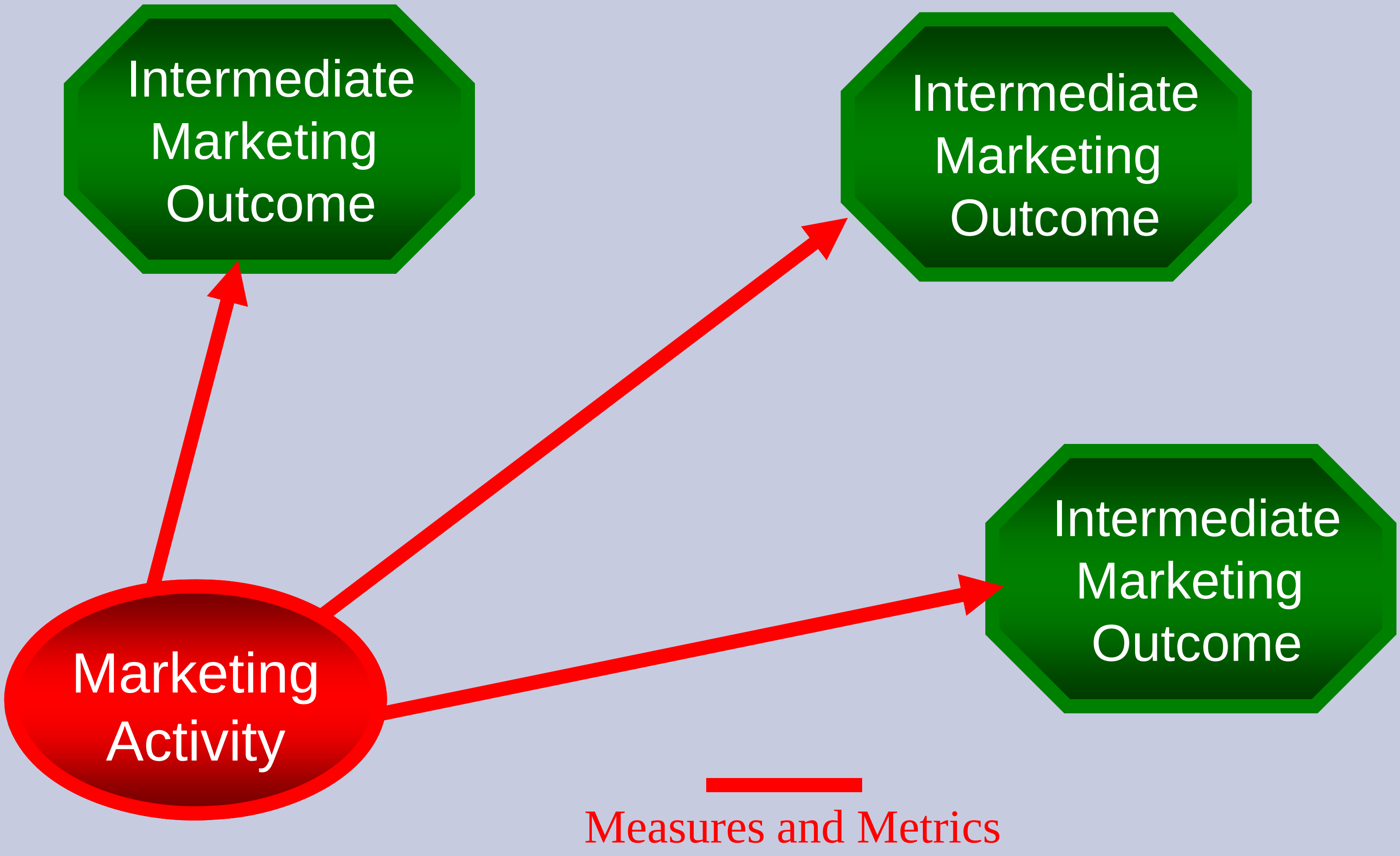
Step 1: Identify Cash Flow Drivers/Business Model

Business Model
(How the firm generates Cash)



Source Of Cash
(Customers)

Step 2: Identify Intermediate Outcome Metrics



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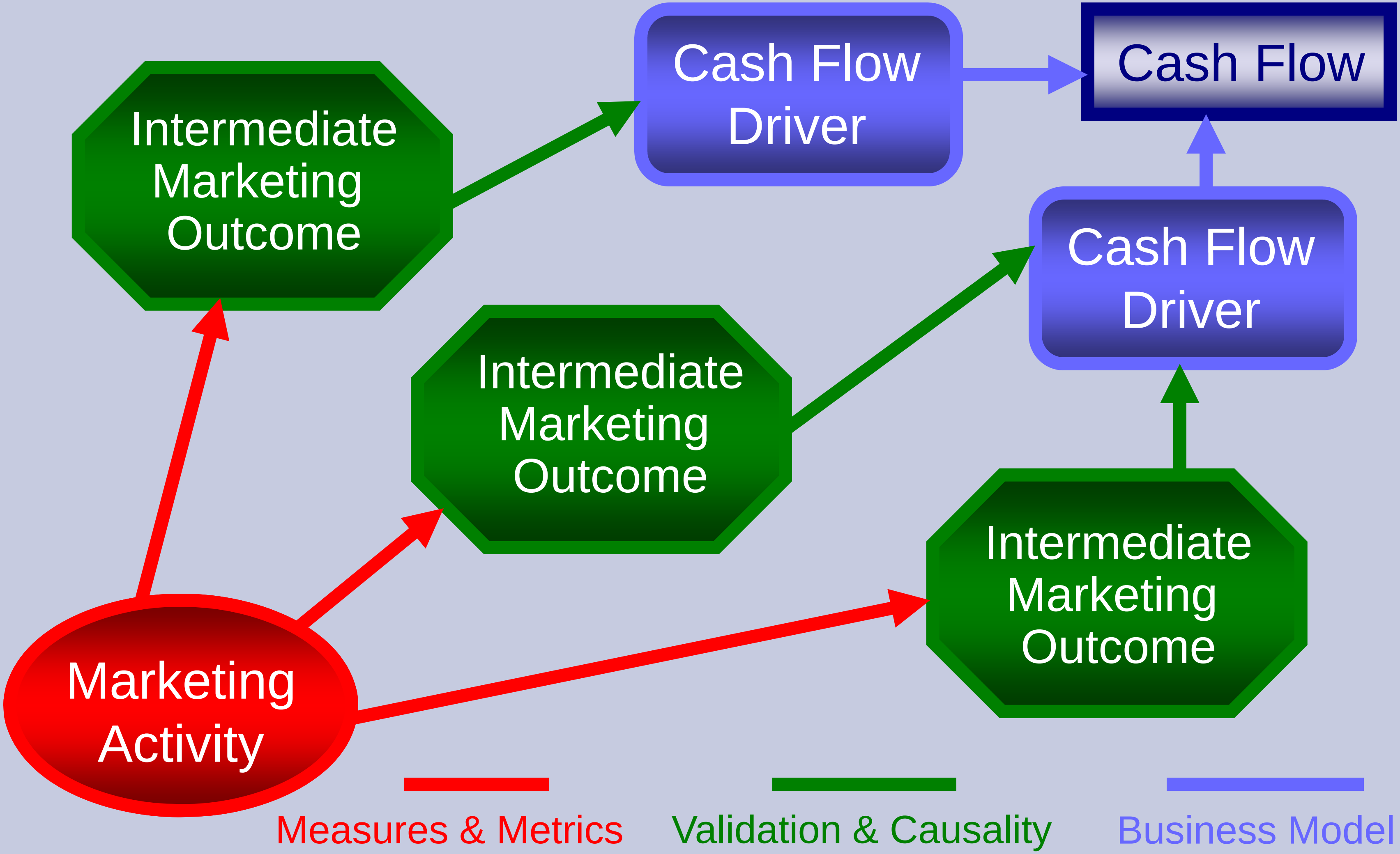
Step 3: Identify the Conceptual Links



Step 4: Validation & Causality Audit

- Every intermediate marketing outcome metric should be validated to short-term or long-term cash flow drivers and ultimately cash flow…including causality
  - This will cost money, but
  - It will facilitate forward forecasting & improvement

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. Accountability is no longer an option
   - There is much unnecessary confusion about accountability.
   - Accountability is ultimately about economic/financial outcomes
2. Need standard measures related to short-term incremental results <u>*and*</u> 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 the setting of measurement and accountability standards

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.).

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Thank you!

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