

MASTERING THE MARKETING MIX

“ Marketers can better demonstrate the value of their investments with an analytical ROI framework that makes sense of previously inscrutable marketing choices.”

STATUS REPORT ON QUANTIFYING MARKETING ROI

WHY IT HAS BEEN DIFFICULT TO QUANTIFY MARKETING ROI

Few broadly recognized standards for how to measure marketing ROI

Historically, little pressure to prove measurable returns on marketing expenditures

Marketing spending is often dispersed across the company, particularly at the product level

Proliferation of customer touchpoints

WHY MARKETING ROI IS SO IMPORTANT NOW

Less tolerance for investments that cannot be fully accounted for

Development of new techniques for gauging marketing ROI

Decentralization and outsourcing of more marketing functions threaten corporate brand-building and weaken long-term product innovation

WHAT TO DO TODAY

Understand brand value growth opportunities and potential areas for protection

Inventory all marketing spending across the company—from corporate branding campaigns to local direct-mail outreach

Examine the marketing ROI framework now being used by leading companies

Identify the technique or techniques that can bring the greatest improvement most quickly

Mastering the Marketing Mix

BY MICHAEL D'ESOPO AND SIMON GLYNN

Chief executives and their CFOs want every investment penny to go toward growth—and so they should. As global competition intensifies, they are far less tolerant of spending that is hard to quantify. At the top of their checklists are marketing investment decisions, which critics charge are based more on feelings than on facts.

Leading companies are beginning to see what they are getting for their marketing dollars. They are applying an approach whose three quantitative techniques make sense of previously inscrutable marketing choices: such as spending more on word-of-mouth campaigns than national advertising, for example, or selecting one direct-mail approach over another. The approach allows marketers to invest more effectively—and it makes them more accountable in terms of returns on investment (ROI). The following case profiles show how.

WITH EYES FIXED FIRMLY ON GROWTH, CEOs are now acutely aware that their marketing investments are perhaps the last significant elements appearing on financial statements that lack clear links to revenues and profits. CFOs are in lockstep with CEOs, calling for results from the last few quarters' investments and limiting future spending if they don't like what they see. In fact, it is common for most C-suite executives to view marketing as a sinkhole full of investments with undocumented returns.

Some companies are deploying new marketing science techniques to yield fact-based analyses that make it easier for managers to decide where to invest

Marketers are in no position to argue. They do not deny that competitive pressures are more intense and profit margins remain vulnerable. Yet they are compelled to support faster and more frequent new product introductions—another outcome of fierce global competition. They have to do so with hands tied behind their backs, because they lack the ROI data to make a compelling case for suitable budgets. And today, the corporate marketing department no longer has the influence it once enjoyed.

Financial pressures, a shift in channel power, and marketing's inability to document its contribution to business results have combined to force reductions in marketing spending and influence, and to accelerate a transfer of funds and responsibilities to the field sales organization, notes Dartmouth's Tuck School of Business professor Frederick Webster, Jr., in an article in *MIT*

Sloan Management Review. Webster and his co-authors point out the dangers in the disintegration of the marketing function—a short-term focus that hurts product innovation, weakens brands, and impairs companies' abilities to identify and reach future customers and markets.

Marketers face an uphill struggle. More than one-third of CEOs say their marketing organizations need improvement, according to a recent survey. Some chief marketing officers (CMOs) and their lieutenants are making heroic efforts to communicate in fiscal terms, as demonstrated in the regular ROI sessions at the annual CMO Summit, hosted by McKinsey & Co., the Marketing Science Institute, and the Wharton School of the University of Pennsylvania.

The extent of the struggle can be seen in recent surveys. According to the 2005 Marketing ROI and Measurement Benchmark Study from consultancy Lenskold Group and MarketingProfs.com, only one in five marketers uses marketing ROI, net present value, or another profitability measure for at least some of their marketing work. More than half admit that their ability to measure financial returns is "a long way from where it could be." It is not surprising that the average tenure of CMOs for North America's top 100 branded companies is less than 24 months, according to executive search firm Spencer Stuart.

If any industry sector has made headway in establishing marketing ROI, it is the consumer packaged goods (CPG) business. CPG companies have spearheaded the use of growing volumes of data from the point-of-sale (POS) and applied techniques such as historical time series analysis to identify patterns in purchasing trends. They have looked across company functions to see where marketing money is being spent, building up in-house skills in marketing ROI in the process. As a rule, they regard their analyses of purchasing data as an ongoing investment allocation process—not just a “one-off” annual budget exercise.

But even CPG leaders tend to be limited by what is available from scanner data. And their focus is on product pricing, coupons, promotions, and flyers rather than on broader marketing questions about, say, the efficacy of direct mail or the impact of regional advertising.

A PHASED APPROACH TO MARKETING SPENDING

Leading practitioners look at marketing spending from a “whole company” viewpoint. They apply a multi-phase process to managing the spending by:

- 1. Assessing overall marketing spend and determining how investments are allocated.** For many businesses, it may be the first time that marketing data has been fully aggregated across the company. These steps will help to clarify the current allocation process. They also highlight investments for which ROI can be confidently calculated as well as the investments that require additional information.
- 2. Building a roadmap for optimization and determination of ROI.** This calls for identifying the investment “cells” (the combinations of products and channels) that require further analysis, either to determine ROI or to improve it. The managers will pinpoint the most effective techniques for the situation—historical analyses or structural equation modeling or in-market experiments—and specify the cells to which early learnings can be extrapolated.
- 3. Conducting the analyses and incorporating the results into a decision tool for optimizing spend allocation decisions.** Now managers can start to see how to make trade-off decisions: whether more should be spent on direct mail and less on print advertising, for example.
- 4. Using the analytical results to help set new marketing budget targets for the coming year.** The outcome will depend on the company’s business strategy, brand strategy, and the results of the optimization exercise.
- 5. Establishing the factors that can encourage ongoing updates of ROI—the necessary processes, skillsets, and organization models.** Those factors will also acknowledge that the marketing mix changes over time as the business strategy shifts and consumer responses change.

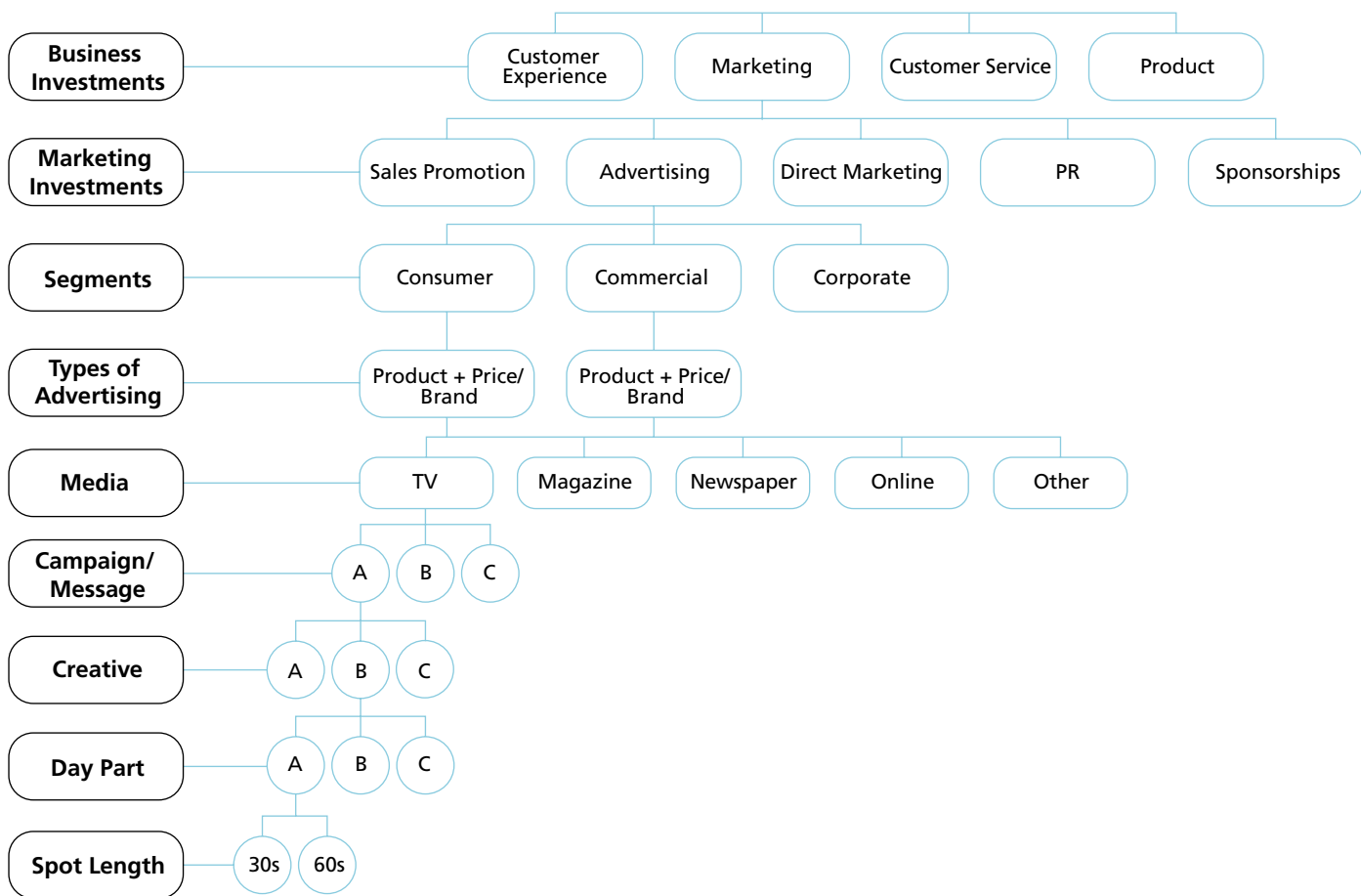
BARRIERS TO ACHIEVING MARKETING ROI

There is no shortage of opinions about how to determine marketing ROI. First, there is the question of which ROI numbers to use. For example, one recent poll found that marketers have 27 ways to define leads. There are few company-wide standards, let alone industry standards. It is not likely that any metrics marketing may possess will be in line with the CEO's agenda. At the same time, the proliferation of customer "touchpoints" increases the number of data elements that must be monitored. In turn, the more data that is collected, the greater are management's expectations of being able to derive value from it. There is also a tendency to track data only by individual product lines or across a function, but not across several functions in the company. And there is the perennial mismatch between long-term marketing goals and shareholders' short-term payback targets.

One other impediment is worth mentioning: it's what we call the "low-hanging fruit problem." It is very typical for the marketing programs whose returns are more easily quantified to enter into a vicious cycle of ever-increasing funding, regardless of their business impact. Recently, though, some companies have found ways to isolate and quantify the factors that influence customer behavior. They are deploying new marketing science techniques to yield fact-based analyses that make it easier for managers to decide where to invest.

These techniques fit into a hierarchical framework where the top levels focus on how well marketing investments stack up against other business investments. The next level down allows marketers to gauge one marketing investment against another within well-defined categories. For example, they might compare the ROI of direct mail versus telemarketing, or a corporate brand-building campaign versus several regional product advertisements. The levels enable crisp decisions about specific program trade-offs: a 60-second ad spot on local radio versus a 30-second one, for instance. (See "The marketing ROI hierarchy.")

THE MARKETING ROI HIERARCHY



THREE CRITICAL ROI TECHNIQUES

This paper will describe three related techniques that correspond to the hierarchical framework. It will address the advantages and limitations of each technique and give three examples of where they are used in practice to deliver significant benefits. Drawn from econometric analysis, the techniques are now being used increasingly in business. Used separately—each for its own application—they can provide significant gains. Used together, they offer marketers a powerful advantage. The three techniques are described below.

1. Structural equation modeling

This is a cross-sectional statistical modeling technique used more for confirmation than for exploration. (Its roots are in sociology; it uses the covariance data matrix to estimate the structural and measurement relationships implied by the hypothesized models.) It usually includes detailed market research with key constituencies to measure perceptions and impact on choice. Combined with historical analyses, structural equation modeling can tie activities such as marketing expenditures to a customer's perceptions and spot trends between the customer's likely behavior and actual behavior, along with the financial outcomes of that behavior. It helps answer questions such as "Is the return on one investment higher or lower than the return on another?" and "Why is ROI low or high?" But it cannot definitively say what the ROI is: it is ideal for "first blush" prioritization of several different investments. It is usually done once, not continuously, and uses cross-sectional variation (variations across researched respondents) to yield conclusions. The technique is most readily applicable at the top level of the hierarchical framework, where the goal is to understand the ROI of marketing relative to other business investments and to prioritize different categories of marketing investments.

2. Historical analyses

Using a company's existing data records and the natural variance in historical data, statistical models can be developed to begin gauging the effectiveness of each measured medium, and to provide an initial understanding of ROI. The models can directly estimate the link between company marketing activities and financial outcomes, helping to answer the "what" questions more precisely but often without giving much insight into the "why." They are increasingly valuable because of the wealth of data that typical organizations have built up.

Historical analyses can include data across many customers over time and hence make use of both cross-sectional and time-series variation. By their nature, they provide a way to keep track of ROI over the long term. They are most useful at middle levels of the hierarchical framework, where historical data is more readily available. A limitation is that they are backward-looking, and there may be a long lag between when the marketing activity was conducted and when returns can be established. Historical analyses also depend on historical variance. If marketing activities and expenditures have been steady and unchanging, the approach cannot reveal anything—no variance means no learning.

3. In-market experiments

Historical analyses can only address the returns on investments already made. With untested ideas or investments, in-market experiments are best for learning how ROI can be improved in the future. They use experimental design techniques that allow the testing of several variables at once. The analyses of data gathered from a few test "cells" are used to extrapolate information about untested cells, and the optimal cells are then chosen from thousands of combinations. Such experiments can help pinpoint what improves ROI and provide a means for determining continuous improvements in ROI. The experiments generally work best at lower levels of the marketing hierarchy—for example, testing the optimal duration of a print ad or the spot length for a TV ad position or testing the design elements of a direct mail piece.

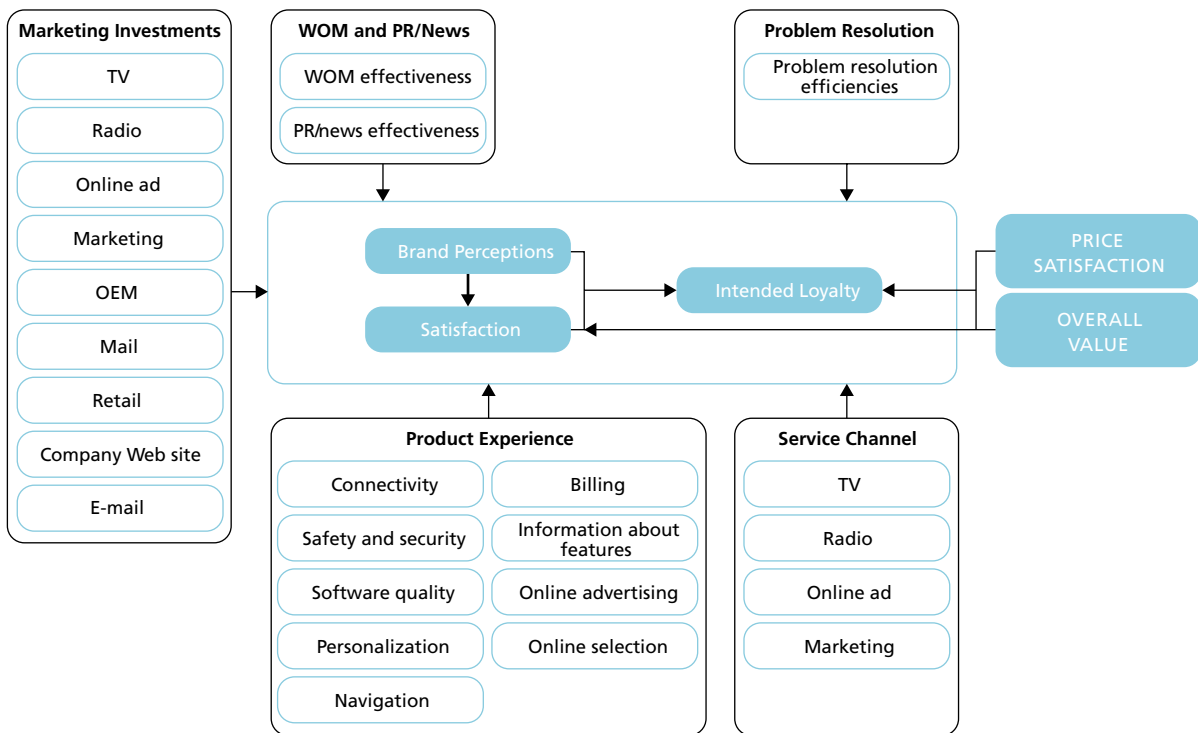
On the next few pages, we'll look at each technique in practical use.

THE POWER OF STRUCTURAL EQUATION MODELING

Company A, a leading online grocery provider (not its real name), had focused mainly on corporate branding that communicated an “ease of use” message. Although useful when the category was new, that message had begun to seem undifferentiated as the category had grown. Yet Company A’s advertising spend has tripled from the late 1990s, with almost three-quarters of that outlay dedicated to TV placements.

The company’s marketing, customer service, and product management operations had all grown up separately; the factors that influenced customers’ selection of Company A were not clear to any group. Aware that the “ease of use” message was losing effectiveness but unable to pinpoint why, the grocer’s marketing team launched a major research program to help define an overall portfolio of spending and to reveal the best trade-offs among different business spending elements (marketing versus service or product experience, for instance), as well as the trade-offs among different marketing investments (for example, word-of-mouth vs. TV, direct mail, and e-mail).

THE MANY INFLUENCES ON COMPANY A’S CUSTOMERS’ LOYALTY



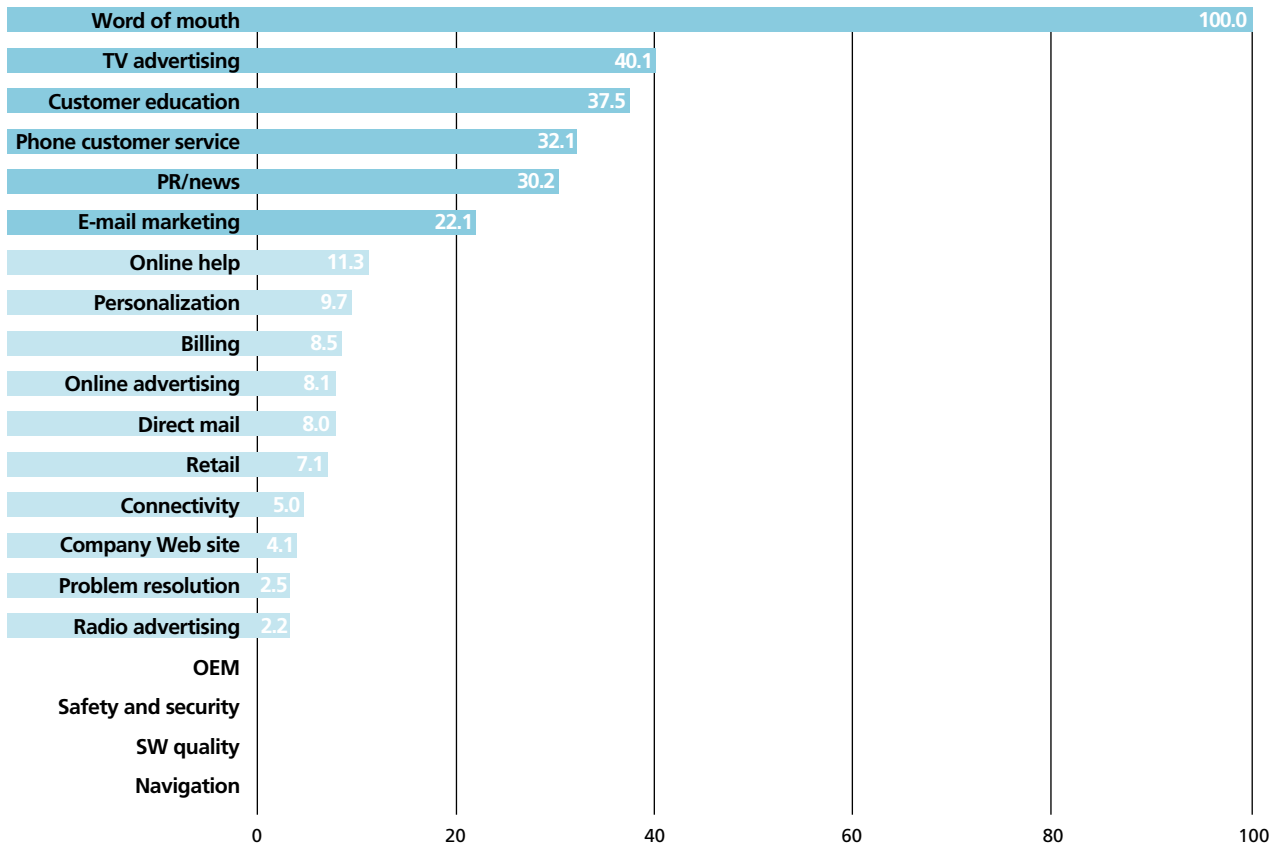
Working with brand consultants from Lippincott, Company A's marketers first used structural equation modeling to map all the influences on the loyalty of their customers and on the likelihood that prospects would sign up with the company. The marketers then kicked off an extensive research effort, polling 3,500 customers and prospects and interviewing others in depth.

Analyzing the findings, the company was surprised to learn just how important word-of-mouth was to how customers and prospects viewed Company A's value. In fact, TV ads—Company A's traditional vehicle for delivering its message—came in a very distant second. The return on a dollar spent on word-of-mouth activities was likely to be at least two-and-a-half times more effective than if that dollar were spent on TV advertising. And it was troubling to find that the company had very little positive reputation with non-customers.

The realization that such influencing factors were not part of marketing's traditional responsibilities allowed Company A management to see the value of a "whole-company" approach to customer loyalty—a first for the company. In addition, the research revealed that although TV advertising was still seen as "cool and exciting," it was not necessarily perceived as relevant, since the market had outgrown the "ease of use" messaging.

The results of the research have convinced the company to take word-of-mouth seriously. Company A has now shifted significant marketing resources to develop specific "buzz-creating" programs to leverage its strong positive word-of-mouth reputation and to reduce negative word-of-mouth among prospects. For the first time, it is aiming public relations efforts at consumers, because PR ranked higher than expected as an influence factor. The company has also recently modified its TV messaging to focus more on communicating specific benefits rather than on conveying the "ease of use" of online grocery services. The new TV messages have played out well in the marketplace. They are more relevant to prospects and customers and have increased the numbers of prospects who view the company favorably by nearly one-third.

NEW NEWS FOR COMPANY A: WORD OF MOUTH IS BIG



THE VALUE OF DEEP HISTORICAL ANALYSIS.

Company B, a leading maker of computer accessories, was spending about \$300 million a year on advertising. It had three major advertising goals, each with significant challenges, as explained below:

1. Corporate-wide brand advertising

The objective was to communicate the identity of the “new” company following a controversial merger. Company B’s core challenge was twofold: to determine how long to continue corporate-wide brand advertising and to gauge the ROI on those expenditures.

2. Segment-specific brand advertising

Company B needed to re-establish its brand with several categories of consumer and commercial customers worldwide. But the company was unclear about how many campaigns it could run given a more constrained advertising budget and stronger competition for marketing dollars overall. And Company B's marketers could not estimate the ROI for their segment-specific campaigns.

3. Segment-specific "call to action" advertising

At the same time, Company B was running several hundred product-specific ads designed to spark immediate consumer purchase decisions. The promotional ads did generate demand, but the resulting sales spikes meant that marketing staff then tended to favor "more of the same"—without understanding the promotional ads' aggregate ROI or the opportunity costs of not running more corporate brand advertising, for instance. Although marketing managers suspected that this siloed approach was inefficient, they could not say with certainty which campaigns worked and which did not.

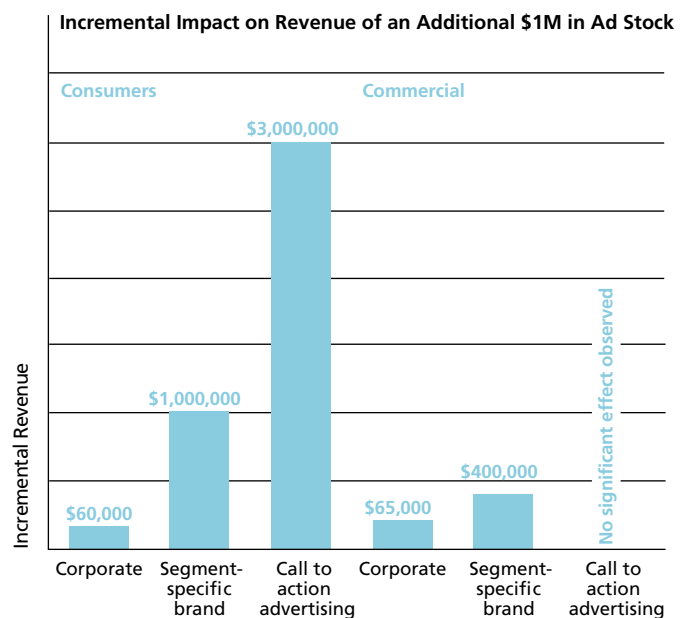
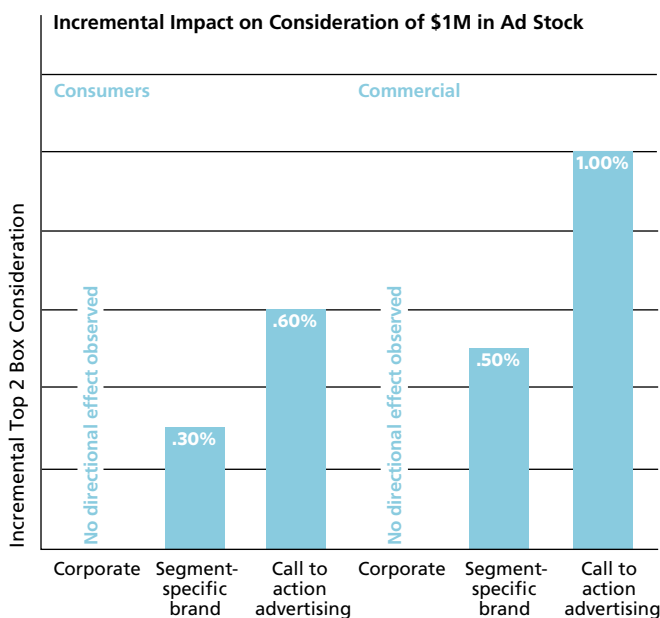
Furthermore, Company B needed to understand and quantify the direct role of advertising in both brand-building and consumer purchase decisions. It was important for them to optimize the spending allocation across different media (i.e., TV, radio, newspapers, online, magazines, etc.). The company's marketing challenges also had a strategic dimension: what role should advertising play as Company B worked to establish its "new" identity with large corporate customers? Up to that point, there had been no significant efforts to identify ROI for any level of the company's advertising. So, Company B's chief marketing officer, director of brand strategy, and the marketing finance chief set out to model the short-term and long-term impact of the incremental dollar spending in each area.

They assembled a team comprising several of its senior marketers along with brand consultants from Lippincott, and they amassed several years' worth of data on different types of advertising expenditures, on brand perceptions, and on financial outcomes across all units of the company—the first time such data had been aggregated for Company B. The team used sophisticated time-series techniques such as distributed lag modeling to understand the impact of ad expenditures on both financial outcomes and brand perceptions. It quickly became apparent that the segment-specific brand advertising Company B used with particular customer segments was more effective than its corporate-wide brand advertising. Indeed, the revenue impact of the segment-specific advertisements was many times that of the corporate-wide advertising. (See "Advertising's impact on brand preferences.") The findings did not imply that Company B should discontinue its corporate brand campaign; they showed that it was a

necessary foundation for the segment advertising programs. The corporate campaign has now been scaled back in favor of more segment-specific ads.

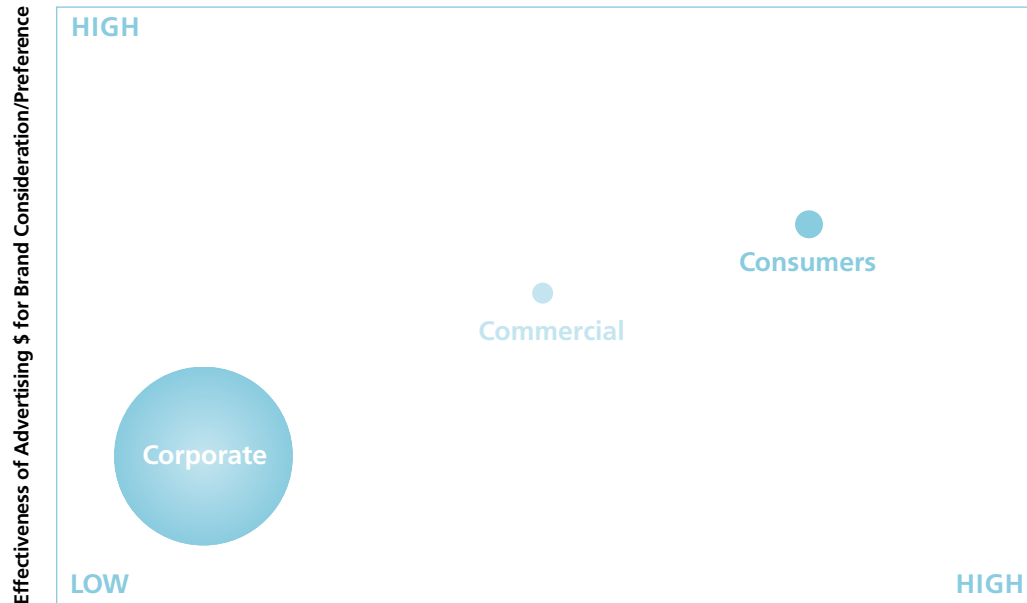
The team’s analysis also found that brand advertising did have a positive return on investment—1.4 times the cost—but the returns from the promotional “call to action” advertising were more than triple the expenditure. For the first time, Company B could quantify the role of “call-to-action” advertising relative to brand advertising—a significant step toward making informed allocation decisions at budget time. (See “Analysis showed clear benefits of specific product-position ads.”)

ADVERTISING’S IMPACT ON BRAND PREFERENCES



ANALYSIS SHOWED CLEAR BENEFITS OF SPECIFIC PRODUCT-POSITION ADS

Bubble denotes size of spending:



Effectiveness of Advertising \$ for Revenues

The historical analyses have sparked significant changes in Company B's relevant business processes. The corporate and divisional marketing teams have collaborated to consolidate advertising agencies and built processes that make it easier to collect and collate "call to action" advertising data. (The agencies are now required to take a more disciplined, systematic approach to gathering and collating the data.) Company B now has a central function that brings together financial, advertising, and tracking data that provides hard data for developing ongoing ROI models. An ongoing ad budget allocation system has been added on top of the yearly budgeting process. In the past, the segment and call-to-action campaigns had been the province of specific product marketing operations.

The company has also changed how it buys media. Its marketers no longer make big campaign decisions just a few weeks before launch. By releasing funds early and reducing the number of unplanned changes to advertising vehicles, they estimate savings of as much as \$5 million a month.

The new ROI
framework
encourages,
rather than
confounds,
collaboration
across business
functions

THE VALUE OF IN-MARKET EXPERIMENTS

Company C, a leading regional provider of home-maintenance products, has made good use of in-market experiments. Although the company was spending more than \$200 million each year on marketing efforts in its consumer group, it was not using any sophisticated testing approaches to determine and improve ROI. In fact, Company C lacked both the resources for testing and a disciplined testing methodology that was efficient and scalable.

As a result, good ideas were going untested, and marketing strategies were put into play based on individual opinions or anecdotal evidence rather than hard facts. As regional markets became even more competitive and marketing budgets were whittled down, Company C's marketing leaders welcomed any approaches that could improve ROI.

The marketing team turned to the following two specific sets of experiments:

1. Determining what makes a great sales call

For one new product category, Company C launched test telemarketing scripts that specified what its telemarketers should say and when to say it. The experiment involved testing nearly 600 potential telemarketing scripts by launching 16 test cells in a live in-market experiment. The "what to say" elements included test sales rep and customer greetings, offer positioning and pricing messages, message order, call closing, and caller ID display.

The test results quickly indicated a 15 to 25 percent lift by optimizing the "what to say" message and a nine to 14 percent gain by improving the "when to say" factor, resulting in more than a 24 percent rise in sales rates. This translated into as much as a \$4 million improvement in incremental annual revenues and more than \$10 million in incremental customer lifetime revenues. Company C subsequently made all of its call center scripts more direct. For example, customers would know immediately who was calling them because the company's name would be displayed as the caller ID. At the same time, the company clamped down on inefficiencies such as excessive small talk and trained the sales reps to close aggressively.

2. Identifying the best direct mail package

Company C's marketers tested the envelope format, the presence of a teaser, the presence of the logo on the envelope, the number of offers, the letter format, and more. Their goal: to increase inbound call center volume and ultimately sales. The results indicated a 100 percent difference in the inbound call volume between the best and worst direct mail packages, indicating significant potential for improvements. Nearly 3,000 potential direct mail packages were tested by launching 24 test cells in a live in-market experiment.

The two sets of experiments have provided Company C with a framework for experimentally designed testing, with real hands-on testing experience. The company's marketing leaders are now rolling out similar tests across different products and channels to improve the current marketing ROI.

TECHNIQUE	WHEN SHOULD IT BE USED?	WHAT TYPES OF QUESTIONS DOES IT ANSWER?
STRUCTURAL EQUATION MODELING	<p>When the objective is to understand how marketing investments stack up against other business investments in terms of driving customer consideration and other relevant business outcomes.</p> <p>When actual data on investments and outcomes is not easy to obtain because it is not tracked consistently or because it is dispersed across the organization.</p> <p>When the aim is to quickly get a relative rank ordering of ROI rather than a precise ROI number.</p>	<p>Is the marginal ROI in customer service at the call center likely to be more or less than the ROI in e-mail marketing?</p> <p>What are the potential areas for investment in the call center that would improve the return disproportionately?</p>
HISTORICAL ANALYSES	<p>When there is rich historical data on investments made over time within a well-defined category (i.e.; advertising) and on the resulting business outcomes.</p> <p>When the goal is to build a case for investment decisions within certain categories or to guide investment reallocation across different categories, and a precise ROI number is desired.</p> <p>When the objective is skewed toward finding “what ROI is within a certain category” rather than “how ROI can be improved in the category.”</p>	<p>What is the return if I invest an incremental dollar in TV advertising as opposed to call-to-action advertising?</p> <p>How much can I improve the overall return on my marketing spending if I shift 20 percent of my TV advertising dollars to magazine advertising?</p> <p>Do investments made in direct mail meet a threshold rate of return?</p>
IN-MARKET EXPERIMENTS	<p>When the objective is to improve ROI in a certain category and there are several competing ideas to do so.</p> <p>When the objective is to quickly and efficiently prioritize several different ROI improvement tactics that have never been tested before.</p> <p>When precise ROI numbers are required for different potential tactics in order to build a compelling business case for a new plan.</p>	<p>In our telemarketing scripts, are we better off opening with a benefit statement than with a product promotion? Is it better to go for an aggressive close or give the customer time to decide?</p> <p>What is the potential improvement in response rates over business-as-usual of adopting one tactic over the other?</p> <p>How, with limited resources, do we design a process for testing thousands of ideas quickly and efficiently and for picking the ideas that promise the most performance improvement?</p>

WRAP-UP

Marketers now have an unprecedented opportunity to demonstrate the value of their initiatives. The analytical ROI framework helps them make sense of complex and seemingly chaotic marketing investment patterns and allows them to quickly reach compelling conclusions about future marketing commitments. It provides the impetus necessary to break away from “always done it this way” inertia and the fact base to push back against outside agencies —particularly advertising firms—that can be reluctant to accept quantitative measures of effectiveness.

With new ROI techniques at hand, marketing leaders can confidently take a portfolio approach to their investments. This approach is relevant to spending beyond their traditional span of control, in functions such as customer service and product development. The new framework encourages, rather than confounds, collaboration across business functions.

Perhaps most satisfying of all, marketers now have the wherewithal to silence critics who have long griped about marketing’s “squishy” decisions.

If anything, the pressure to rein in “non-growth” costs will only increase. There will always be barriers to gauging returns on marketing investments, but there are fewer excuses for not doing so. Leading companies are gaining a competitive edge by applying the new marketing ROI approaches. They are gaining experience with them, fine-tuning them, gathering more valuable data with them. Competitors who do not take a keen interest in what the marketing leaders are doing today may not be effective competitors a few years from now.

ABOUT LIPPINCOTT

Lippincott is a leading design and brand strategy consultancy. The firm was founded in 1943 as Lippincott & Margulies and pioneered the discipline of corporate identity. Lippincott operates globally from its offices in the United States, Europe, Asia and the Middle East. Recent clients include American Express, AOL, Citigroup, Delta Air Lines, ExxonMobil, Goldman Sachs, IBM, Mashreq, McDonald's, Nissan, Samsung and Sprint. For more information, visit www.lippincott.com.

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