TRY A PORTFOLIO APPROACH TO MANAGING MARKETING SPENDING.

UNRAVELING THE MARKETING MYSTIQUE

BY NARAS V. EECHAMBADI

Perhaps no other major area of corporate spending and investment is as hard to measure and to hold accountable as marketing (although sales and IT can provide some stiff competition!). The reason? Marketing can have so many different objectives that sometimes seem to be contradictory or irreconcilable, and the impact of marketing can also vary a great deal from the ephemeral to the very real. This is an important issue for most companies as they seek to become increasingly efficient and competitive in the marketplace, given that marketing expenses typically compose from 5% to more than 20% of corporate revenues. The ability to make this expenditure more accountable and effective can have great leverage on the overall performance of most companies.

Figure 1: THE MARKETING PERFORMANCE FRAMEWORK: CUSTOMER ENGAGEMENT CYCLE

	AWARENESS	CONSIDERATION	INQUIRY	PURCHASE	EXPANSION
BUSINESS OBJECTIVES	Breakthrough and recognition	Relevance and inclusion in decision set	Differentiate and inform through two-way sharing	Move to desired action; shared commitment	Ongoing engagement and development
EVENT DESCRIPTION	Presentation of messages and/or an initiation of contact designed to generate customer awareness of brand, product, or service	Presentation of messages and/or an initiation of contact designed to encourage prospective buyer to demonstrate interest in brand, product, or service.	Exchange of information in a two-way dialogue or targeted information request	Actions designed to encourage commitment—purchase, loyalty, etc., leading to an exchange of value	Actions designed to encourage additional exchange of value and deepening commitment

Marketing return on investment (ROI) has become a popular notion bandied about by many consultants and marketing organizations in response to the demand for greater measurability and accountability for marketing spending. But the search for measures of "marketing ROI" may be futile, misleading, and downright counterproductive unless it is preceded by a clear understanding of the basis for marketing expenditures across the organization, its products, and its customer segments. Before undertaking the task of determining ROI, financial executives must understand where the money is being spent, for what purpose, and how the stated objectives do or do not impact revenue, margins, or other financial measures.

Some marketing expenses aren't investments—they're just an ongoing cost of doing business. Others have long-term benefits, including risk reduction, i.e., the protection of revenue and market share in highly competitive or declining markets. Understanding the difference is critical. This exercise of specifying objectives and time frames can itself be extremely valuable and insightful and lead to significant increases in efficiency and effectiveness. Linking marketing objectives to financial goals through rigorous ROI computations should follow as a logical extension of this exercise. The determination of ROI is more achievable once the links are made but can be meaningless without this prior context, which provides the necessary framework for the ROI analysis.

THE PORTFOLIO APPROACH

For financial officers who are mystified by marketing, a portfolio management approach offers a familiar and comforting way to help them understand how to break down the problem and analyze it. Marketing programs and budgets can be approached using a *portfolio framework*. Financial asset managers use portfolio theory to allocate investments, seeking to maximize return while minimizing or spreading risk. They also hedge against currency and commodity price fluctuations while seeking to protect margins, and they spread investments across multiple time horizons to protect against rate fluctuations. CFOs are used to differentiating between operating cash that's managed from a short-term perspective and cash that's used strategically to provide a buffer from downturns or acquire other companies. They are also familiar with the hedging of currency and commodity risk through the use of derivatives to smooth out costs and revenues over time, as well as being long and short on bond and stock portfolios depending on whether reducing risk or maximizing returns is the critical objective. Looking at marketing expenditures via a similar approach, without straining the analogy too much, provides a useful and familiar platform for CFOs to engage their bosses or their peers, including the chief marketing officer (CMO), in a dialogue on how to get the best return on marketing spending without sacrificing long-term shareholder value creation.

Before going deeper into this issue, it may help to reiterate the major objectives or desired outcomes of marketing spending. At a very high level, the answer is simple: to increase revenues. Marketing can achieve this in a variety of ways. The most obvious and important areas of revenue generation that marketing heavily influences are:

- Acquisition of new customers,
- Increasing revenue from current customers,
- Retaining existing customers, and
- Supporting higher prices and margins (by increasing brand equity).

Marketing has plenty of levers to use to influence each of these areas. The obvious and most important ones are:

- Advertising,

Figure 2: THE MARKETING PERFORMANCE FRAMEWORK: MEASUREMENT DIMENSIONS

MEASUREMENT DIMENSIONS	AWARENESS → CONSIDERATION → INQUIRY → PURCHASE → EXPANSION
ACTIONS AND ACTIVITIES	Measures the resources, programs, and activities devoted to achieving marketing objectives. These indicators look primarily at programs, inputs, and investments.
MARKETING IMPACT	Measures the results of marketing activities within each stage of the customer engagement cycle (response rates/conversion rates, closed sales, click-through impressions, customer saves, etc.).
FINANCIAL IMPACT	Measures the financial aspects of the marketing programs, including cost and return on investment, at each stage of the customer engagement cycle. These measures link the results of marketing activities to financial outcomes.
CUSTOMER IMPACT	Measures the impact of marketing activities on customer segments (loyalty, satisfaction, profitability, etc.) at each stage of the engagement cycle.
TIME AND MIGRATION	Measures the time required to move customers through the engagement cycle, and provides indicators of migration difficulty.

- Public Relations (yes, it is an integral part of marketing),
- Promotions (trade and consumer), and
- Sponsorships (e.g., sports, shows).

Establish Objectives

The first step in measuring the effectiveness of marketing spending and the returns from that spending is to establish the immediate objectives for the campaign. What are the things you want marketing to do? Help acquire new customers? Convince current customers to stay loyal and increase repeat purchases? The best place to start is to think about it from a customer engagement standpoint. Figure 1 provides a good framework for understanding this within your own context. It is important to realize that there may be multiple, simultaneous objectives for marketing at different levels (company, brand, product) and for different customer and prospect segments. Once you have identified these objectives, the next step is to start identifying specific metrics for measuring effectiveness across these dimensions.

Identify Metrics

Figure 2 provides a framework for identifying these metrics. Filling out this framework can be a fairly involved process (and can get very complex when there are multiple products, brands, and segments), but it is great discipline for a marketing plan and must be built by individual product or brand marketing teams. Once you have established the objectives of marketing, they can be linked in varying degrees to financial measures.

Marketing Mix

Now it's time to turn to the other side of this puzzle, namely, the marketing mix elements, i.e., the instruments. Examples of these are advertising, promotions, sponsorships, direct marketing, and the Internet. The first step is to determine what marketing instruments are being used and how they fit in with the objectives and measurement dimensions listed earlier. This sounds fairly simple, and it is—under certain circumstances. Direct marketing campaigns often have very measurable targets for response, e.g., how many inquiries can be expected as a result of a direct mail effort or how many additional products can be sold at what price. Promotions are also very measurable, but the analysis gets a little trickier since a high response doesn't necessarily mean high incremental revenues because of the impact of price reductions as well as cannibalization. For example, would the customer have bought the product anyway? In that case, you have just succeeded in giving up some of your margin.

Analysis gets even more difficult when you evaluate advertising spending. There are several stages at which advertising effectiveness can be measured, and the following example shows how this can be done at multiple stages to eventually arrive at an estimate of the financial outcome. Using syndicated market research, a luxury car company was able to determine that perceptions of a particular model have improved by 6.7% as a result of a marketing campaign (in this case, they had a perception stage between awareness and consideration). This, in turn, led to an increase of 10% in consideration. Half of the prospects whose consideration improved ended up visit-

Table 1: FROM OBJECTIVES TO INCREMENTAL CONTRIBUTION: A LUXURY CAR EXAMPLE

Perceptions		6.7%	Increase in favorable perceptions
Consideration	x 1.5	10.0%	Increase in number of prospects willing to consider the car
Showroom visits	x 0.5	5.0%	Increase in showroom visits
Close rate	x 0.10	0.5%	Percentage increase in volume
Size of segment	x 500,000	2,500	Incremental cars sold
Marginal contribution per car	x $5,000	$12.5 million	Net incremental contribution from advertising—flowing from improved perceptions

ing a showroom. About 10% of these increased visitors drove away with a car from the showroom. The campaign, geared toward a segment of 500,000 prospects in the target market, led to an incremental 2,500 cars being sold, which resulted in incremental net revenue of $12.5 million. Table 1 shows this example in slightly greater detail.

It's important to remember that there are interdependencies among these elements of the marketing mix. A direct mail campaign that is done in conjunction with an advertising campaign will often draw a higher level of response (and sometimes a higher quality of response) compared to the same campaign that is done standalone. Similarly, a direct mail campaign followed up by e-mails tends to build cumulative effectiveness. Major packaged goods companies understand this very well, especially in the context of introducing new products. They will orchestrate a well-coordinated campaign that combines advertising, public relations, coupons, trade promotion, and point-of-purchase advertising to ensure maximum trial of a new product.

In addition to interactions among different elements of the marketing mix, there are aspects outside the direct control of marketing that can hugely impact the effectiveness of marketing spending. For example, distribution and fulfillment are enablers (and sometimes even drivers) of volume in many categories. Usually these are outside of marketing's control, but you need to take them into account when putting together a marketing plan. There's no sense in advertising, dropping coupons, sponsoring events, or mailing to prospects in areas where customers can't find a product or service. On the other hand, a well-orchestrated campaign using multiple channels will result in the messages reinforcing each other to maximize overall effectiveness. Service levels can also have a significant impact on marketing programs. AT&T Wireless spent enormous amounts of money on the M-Life marketing campaign during 2002-2003, but it was losing customers by the millions because of problems in one of its main servicing platforms. Similarly, Sprint PCS became the first major cellular phone company in 2003 to lose customers year over year, despite huge marketing expenditures, because of very poor service levels compared to its peers. These companies would have seen better return if they had redirected advertising spending to investments in their customer service infrastructure. Capital One, a very aggressive and successful direct mail marketer, which does a superb job of measuring the financial effectiveness of marketing campaigns, has seen the effectiveness of direct marketing campaigns increase significantly after it started spending heavily on television advertising a few years ago and built up a more recognizable brand name.

Impact of Marketing Mix Elements

For the purpose of this illustration, let's look at each of the marketing mix elements and consider how they typically serve the various objectives of marketing. The quality of the campaigns (creative content, compelling message, targeting of the right customers) plays a huge part in the success of marketing initiatives. Assuming that the messages are well developed and appropriate, the matrix in Table 2 lays out the typical impact expected from the elements of marketing in the different stages of the customer cycle. Also note that, in this model, the assumption is that the customer or prospect is already in the previous stage and that the object is to move them along the continuum; e.g., you can't expand a relationship with someone who hasn't purchased a product or service, nor can you get any consideration from someone who isn't aware of a product.

As part of a marketing portfolio approach, it's impor-

Table 2

	AWARENESS	CONSIDERATION	INQUIRY	PURCHASE	EXPANSION
Advertising	High	High	Medium	Low	Low
Consumer Promotions (rebates, coupons)	Low	Low	Medium	Varies	High
Direct Response Advertising	Medium	High	Medium	High	Low
Direct Mail	Medium	Medium	High	High	High
E-Mail	Low	Low	High	Medium	High
Website	Low	Medium	High	Medium	High
Sponsorships	High	Low	Low	Low	Medium
Loyalty Programs	Low	Low	Low	Medium	High
Product Design	Low	High	High	High	Medium
Product Placement (Distribution)	Medium	Medium	Medium	Low	Low

Table 3

	PRIMARY OBJECTIVE	COST OR INVESTMENT?	TIME FRAME FOR MEASUREMENT
Advertising	Awareness, Consideration	Investment	Months, Years
Consumer Promotions (rebates, coupons)	Purchase	Investment	Weeks
Direct Response Advertising	Purchase	Investment	Minutes (for TV, Radio), Days (for print)
Direct Mail	Inquiry, Purchase	Investment	Weeks
E-Mail	Inquiry, Purchase	Investment	Hours
Website	Inquiry, Purchase, Expansion	Cost	Ongoing
Sponsorships	Awareness	Investment	Years
Loyalty Programs	Expansion, Retention	Investment	Months, Years
Product Design	Consideration	Cost	Ongoing
Product Placement (Distribution)	Consideration, Purchase	Cost	Ongoing

tant to recognize and understand the role that each of the elements in Table 2 plays within a marketing plan. There are two major considerations here: (1) What is the primary objective of the element, and (2) should it be considered a basic cost of doing business, or is it an incremental investment that should be measured primarily in terms of its return on investment? Also, what is the measurement time frame for each of these elements? Table 3 provides guidance on these issues.

WHAT'S THE PORTFOLIO?

So how does all this add up to a portfolio? As is clear from Table 3, the various marketing elements work very differently in impacting the customer along different parts of the customer engagement continuum. This impact is felt over widely differing time frames. Corporate marketing and product strategies will dictate the appropriate mix of these elements. A mature product that has very high awareness, ubiquitous distribution, and a broad customer base but sluggish sales should focus on minimal maintenance levels of advertising and promotion and probably try direct marketing or promotions to generate short-term sales demand.

On the other hand, a new product may have to focus on advertising and securing distribution as the primary focus, with direct marketing or consumer promotions as supplementary vehicles to generate initial trial. It's useful to map out the different products within a company's portfolio and understand where they fit with respect to key customer and prospect segments and their customer engagement continuums. This can help to deepen understanding of the potential for growth for each product and the time frame for that growth. Given overall company strategy and growth goals and the ability and willingness to invest, allocation decisions can be made across products and marketing mix elements.

Let me illustrate this with an example. We recently worked with a division of a financial services company that had been growing very rapidly over the past five years. This firm offered some innovative consumer services that had been marketed successfully to existing customers of other divisions within the parent company. The parent company's brand name and the fact that most of the target market consisted of existing customers took care of the awareness and consideration issues. The challenge for this division, which it recognized and dealt with successfully, was to generate inquiries and purchases. It did so mostly through successful, targeted direct mail campaigns to these prospects. The existing distribution system took care of the fulfillment. To continue the rapid growth, however, it was necessary to shift gears. The division had to introduce new products that appealed to segments that had not been penetrated, especially consumers who weren't already customers of the parent company and those who lived beyond the current physical distribution reach of the parent company (this division sold products that could be sold and serviced online or by mail). It also became critical to retain existing customers and to devise incentives for them to bring a greater "share of portfolio" to this division (buy more of this division's products).

This shift in strategy required major changes in the makeup of marketing spending. The division needed to spend money on advertising to generate awareness and consideration in geographic areas where the parent company wasn't well known. It also had to invest in call centers and the website in order to fulfill orders remotely since it didn't have a physical presence in these new geographies. Among existing customers, it required an understanding of the current customer portfolio, customer profitability, and the development of targeted loyalty programs aimed at high-value customers.

Meanwhile, a major driver of growth continued to be increasing penetration within the parent company's customer base. Given very tight restrictions on marketing dollars, the division needed to reallocate spending between the traditional direct mail acquisition programs and the required advertising and customer loyalty programs. This was done through a rigorous net present value (NPV) analysis of each of the programs (some based on historical performance, others based on educated guesses about potential response). Dollars were then allocated to those programs that generated the highest NPV and were consistent with the overall strategy (the advertising required some minimal levels of spending that couldn't be justified solely on the basis of NPV). NPV has the virtue of making it easier to compare the returns on programs that have very different time horizons for response. This resulted in a spending split of about 60% to direct mail, 25% to advertising, and 15% to loyalty and customer management programs vs. the earlier allocation of almost 90% to direct mail. The division then monitored the early advertising and loyalty programs to check whether the assumptions made in the NPV modeling turned out to be valid and made adjustments. The expectation is that this process will continue to evolve over time, with customer management spending continuing to become a bigger piece of the marketing pie as the company and its customer base mature. Advertising will probably spike, then decline, and direct mail will remain a significant part of overall spending. This evolution in the mix of marketing spending is healthy and normal for most product cycles but is sometimes distorted by budget battles within marketing when different managers control different elements of spending.

AN OBJECTIVE FRAMEWORK

The portfolio approach provides an objective framework for allocation decisions that can otherwise get very emotional and territorial within most organizations. Finance managers, given the natural discipline they bring and their familiarity with portfolio approaches to resource allocations and commitment to measurement and tracking rigor, can play a crucial and important part in these deliberations. They can be instrumental in determining the nuances of marketing spending by asking the right questions about the specific and quantifiable objectives of marketing campaigns, the time frames for achieving those objectives, and the financial impact of reaching those goals rather than treating marketing expenses as one huge black hole that is a crapshoot at best or a spending sinkhole at worst. ■

Naras Eechambadi, Ph.D., is the CEO of Quaero, a marketing and technology services company that helps companies accelerate their marketing performance. He is an authority on disciplined marketing approaches that maximize return on marketing investments and accelerate growth. Before founding Quaero, Naras was a senior VP at First Union Corp. (now Wachovia), where he created the company's Knowledge-Based Marketing Group. He also has been a consultant with McKinsey & Company, where he was a leader in the marketing practice and a co-founder of the CRM practice. You can reach Naras at naras@quaero.com. For more information about Quaero visit www.quaero.com.