Connect the Dots

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Deciding where to spend your marketing dollars is often difficult, because there is rarely a straight line from the investment to a specific financial result. Much of marketing's impact, the argument goes, cannot be determined directly.

Take advertising, for example. Most research indicates that, for the average packaged-goods company, every dollar invested in advertising provides a return of 56 cents over the short run. By the same token, however, we also know that for most brands, a decrease in advertising will cause a decrease in sales over time.

CMOs often find themselves constrained by the short-term expectations of financial officers or Wall Street. The inability to connect the dots, because of the innumerable variables that can affect sales and the delayed effects of campaigns, puts marketers in the awkward position of trying to rationalize marketing investments using short-term metrics such as "awareness" and "share of voice." This language does not go far with CEOs and CFOs, who are driven primarily by the stricter metrics of financial accounting.

Year after year, the Marketing Science Institute has identified the inability to link marketing metrics to financial outcomes as the number-one issue confronting marketers. This inability reduces the credibility of the CMO (thus, contributing to high CMO turnover) and serves as the fundamental barrier to marketing's evolution into a more scientific discipline.

New tools are emerging to help. Marketing mix models help CMOs guide their investment decisions using regression-type techniques to estimate the effect of advertising, pricing, merchandising, competitive activity, seasonality and other factors on sales. These models represent the state of the art when it comes to marketing decision making. But while they're effective at providing relative guidance for certain investments, the models tend to have three primary shortcomings:

- They focus on incremental growth instead of baseline sales or long-term effects.
- Their integration of metrics such as customer satisfaction, awareness and brand equity is limited, even though management is told that such measures are important.
- They generally fail to incorporate metrics related to competitors, the trade or the sales force (the average business spends far more on the sales force and trade promotion than on advertising or consumer promotion).

As a result of those limitations, marketing mix models are only a small step in the right direction. The real work lies in making a more explicit connection from investment to metric to financial outcome. This type of analysis represents a perspective that will no doubt form an integral part of how the CMO of the future creates and captures value. In other words, how the CMO drives profitable sales.

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Measuring the Trade-Offs

We have seen some very interesting work to achieve that goal. One good example is Starbucks, whose success in creating demand led to a new challenge: longer average wait times in neighborhood Starbucks coffee shops. (We won't get into the issue of how, in many companies, customer service falls under operations, far removed from the CMO's oversight.)

How might a CMO evaluate an investment in reducing wait times against the universe of other potential investments? This type of investment may seem like a zero ROI proposition, since at first glance it seems to be a more costly way to serve existing demand: Just because the line's shorter doesn't mean that consumers will generate a higher average transaction. Most marketing mix models don't address these potential trade-offs and simply aren't equipped to weigh this type of investment against allocations in trade promotion versus consumer promotion, for example.

What's needed in this case is a straight line between marketing metrics and financial outcomes. The metric in question is customer satisfaction: How much is a shift in customer satisfaction worth? According to a 2004 Harvard Business School case study, a Starbucks analysis of customer satisfaction found that the average "unsatisfied" customer stuck with the chain for a little more than one year, made 47 visits during that period and spent a total of approximately $200. By contrast, the average "highly satisfied" Starbucks customer eight years, made an impressive 86 visits per year and spent a little more than $3,000 over that average eight-year time span.

Once the connection is made between marketing metric and financial outcome, calculating the investment and its potential payoff becomes easier. Based on Starbucks' estimate, marketing would need to invest $40 million annually to sufficiently reduce wait times and convert its unsatisfied customers into highly satisfied ones. Since each highly satisfied customer is worth $3,000 (over eight years) and each unsatisfied customer is worth $200 (for one year) in revenue, Starbucks can simply calculate the discounted cash flow and determine how many customers must be "bumped up" from unsatisfied to satisfied to generate the $40 million in incremental revenue needed to cover the investment. Starbucks deemed the investment worthwhile based on the revenue that these now highly satisfied customers would contribute over the long term.

It is through this connection between satisfaction levels and resulting revenue that we can assess the considered investment and present it in a compelling language to the company's financial managers. Unfortunately, customer satisfaction is just one of many metrics that companies collect but don't sufficiently analyze to understand the priority to desired financial outcomes. They also rarely explore how these metrics interact with each other; for example, how might investments in advertising affect levels of satisfaction and, ultimately, a financial result?

Your ability to understand the value of your customers relative to your marketing investments will, at the end of the day, define your success or failure. Studies show that an increasing percentage of a corporation's value is driven by intangible assets, including intellectual property and, yes, customer value. Your customer base, in other words, represents a distinct revenue stream, and you will sell yourself short (and undermine your ability to make decisions) if you're not able to articulate its long-term value.

At a minimum, connecting marketing metrics to financial outcomes can help you pull the metrics that matter from a growing pile of measurement approaches that have some ethereal, undefined connection to results. More important, this connection will provide the CMO the ability to assess various marketing investments — and more easily justify them to senior management.

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