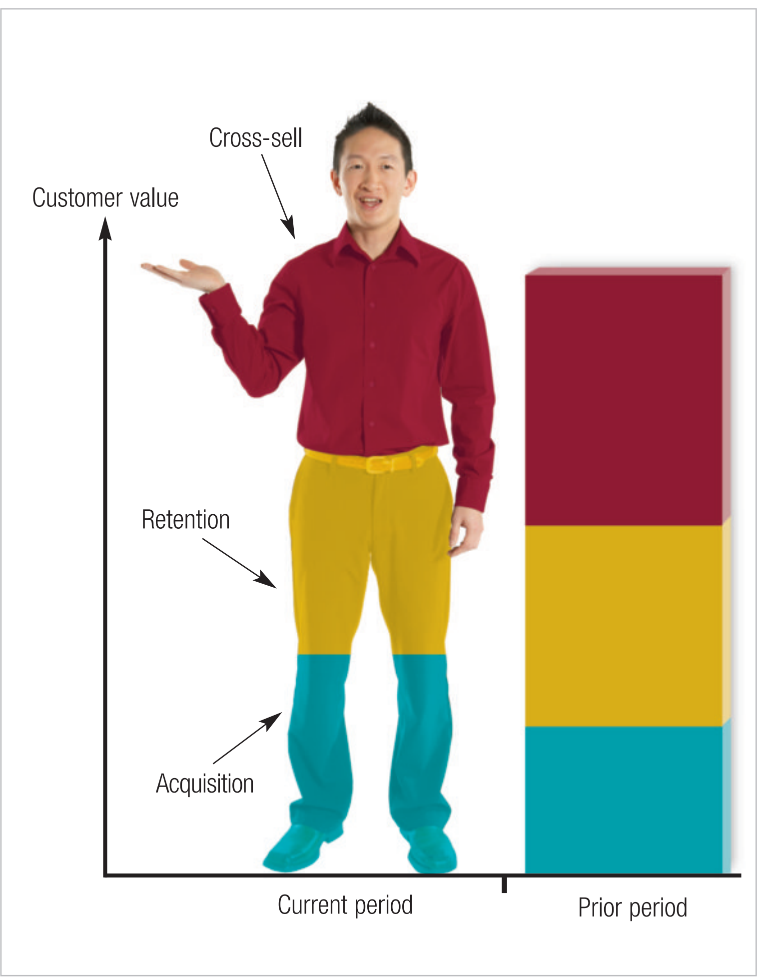
Better Marketing Decisions Every Day

Volume 4, Issue 1

MarketingNPV®

Bridging Short- and Long-Term Investments in a Financial Context

It's a familiar conundrum: Various elements of your marketing program are not intended to fully pay back in the near term, so you're forced to find some creative way to show your brethren in finance or accounting when the payback will occur and with what level of certainty. What's a marketer to do? In this issue, beginning on page 3, we'll take a closer look at customer franchise value, a rapidly emerging way for marketing and finance to align on exactly when and how the investment will turn into return.



Also in This Issue …

***Plus*, more about marketing metrics, dashboards, brand scorecards, and ROI online at www.MarketingNPV.com.**

Bridging the GAAP

The argument is a familiar one: Marketing contends that the investment in programs cannot be solely measured by its short-term impact. They make a passionate case for how the brand is building and how that creates a strategic advantage. They point to customer loyalty over the longer term, and the importance of that as a competitive barrier.

Finance understands the argument, but they can't work with it. There is no ledger account for "brand equity" that they can add to unless the company is acquiring or selling something. Nor can they place a value on "loyalty," unless it's specifically related to the increase in the present value of future cash flows.

The instigator in this perennial tug-of-war is GAAP. Generally Accepted Accounting Principles — authored and monitored by the Finance Accounting Standards Board (fluidly known as "FASBy") — dictate that marketing, advertising, and promotional costs incurred in a given period of time must be entirely booked in that same period. There is no exception for a "long-tail" effect.

So if you want to build a case for spending money today on a program whose benefits will accrue over a period of time, take a look at the feature article in this month's issue starting on page 3. Customer franchise value is a rapidly emerging way for marketing and finance to align on exactly when and how the investment will turn into return. We'll give you a glimpse of how it works.

Also in this issue:

- Kevin Lane Keller, master of brand equity development and measurement, gives us his perspective on why brand equity is so damn hard to measure and what it will take to get it right. See our interview with him beginning on page 7.
- Marketing-mix models are evolving in their structure and application. See how the value of these tools is expanding, and where you need to be careful in relying on them too much.
- It may be early in the budget cycle, but for many of us the request for cuts may start coming soon. In our piece entitled "What to Cut" (page 10), we'll give you a few ideas for how to minimize the effect of the falling axe. A few moments of thought now can save lots of aggravation later in the year.

And, of course, you'll find lots more online at www.MarketingNPV.com. Thanks for reading.

Regards,

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MarketingNPV is a highly specialized consulting firm that builds marketing measurement processes, tools, and skills to determine the financial return from marketing investments. Our key deliverables are marketing dashboards, brand scorecards, and ROI frameworks that measure the creation of economic and strategic value for both the short and long term.

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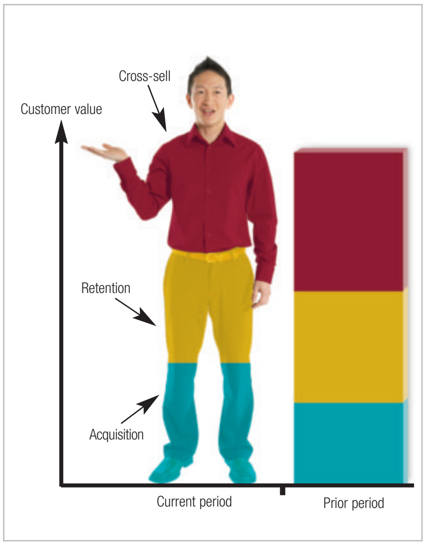
Using Customer Franchise Value to Bridge Short- and Long-Term Investments in a Financial Context

Most CMOs have various elements of their marketing programs that are not intended to fully pay back in the near term, and they have to find some creative way to show their brethren in finance or accounting when the payback will occur and with what level of certainty. This is a particularly vexing problem. Most marketers understand and accept the conventional wisdom that money spent today generates some awareness and changes some attitudes, beliefs, and behavior — some of which falls into the 2007 revenue bucket, and some of which might fall into even longer-term revenue or profit generation. This concept is fundamental to a marketer's understanding of the marketing discipline.

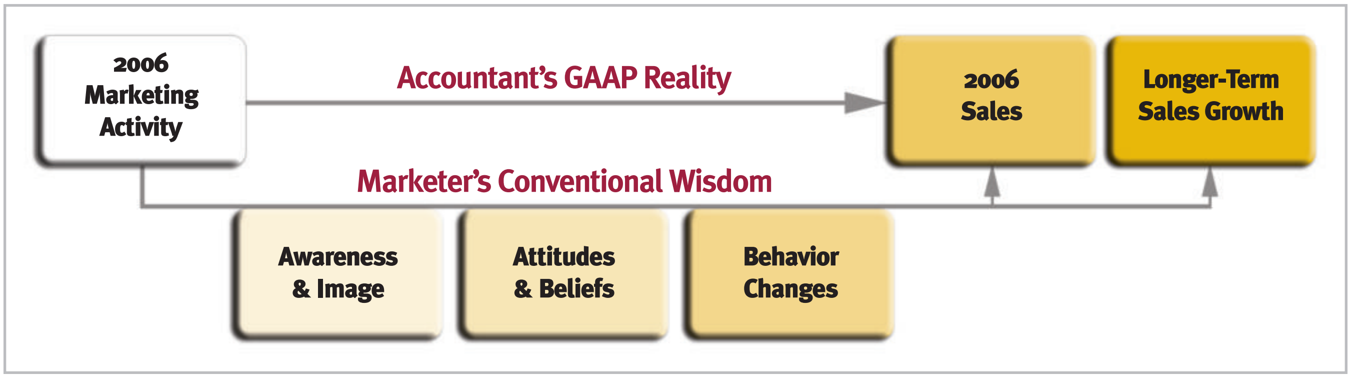
However, it is, unfortunately, not accepted or understood within the realms of finance and accounting. They follow "generally accepted accounting principles," or GAAP reality, which not only clearly dictate but actually require that accountants take any money spent now and book it as an expense now. There is no such thing as a capitalized marketing expense — they've got to take it in the current period against the P&L.



So, it's no wonder that they've got such a strong desire to understand what brand advertising is going to do to generate incremental revenue or incremental profitability in the near term. They just need to be able to figure out whether, from a cost-accounting perspective, this is a better expense than some other investment that the organization is seeking to make.

As a result, marketers need to start developing a more disciplined way of helping them understand the tangible, financial value being created over time — not just the strategic value. (See the Kevin Lane Keller interview in this issue, page 7, for more background on measurement of brand investments.)

Let's go back to shareholder value as the bedrock of that. Marketers understand the concept that an enterprise has a total value based on what its market value might be. If you are a publicly held company, that's easy to calculate. If you are a privately held company, the value is based on what someone might be willing to pay for the firm. The value of the organization is based in two different classes of assets. There are the tangible assets — the net working capital: the cash flow, the property, plant, and equipment — and intangible assets.



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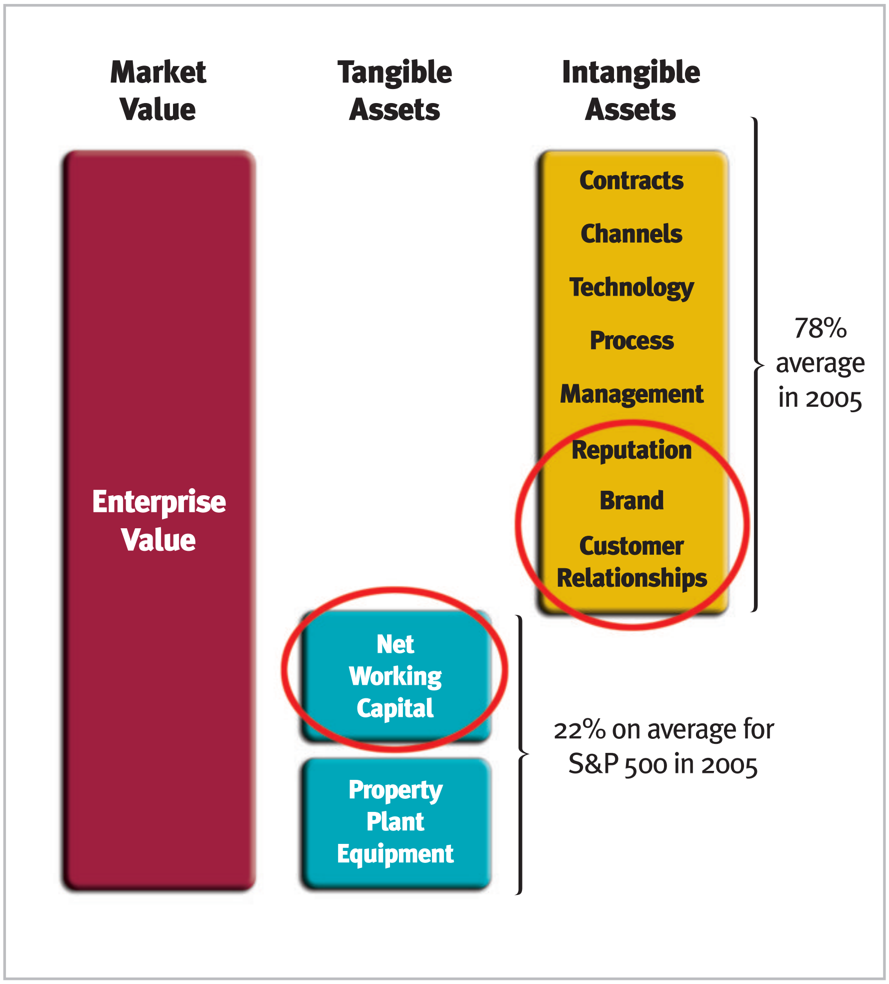


If you were to look, for example, at the S&P 500 in 2005, tangible assets represented only 22% of enterprise value across the entire group, which means that the other 78% of enterprise value was coming from intangible assets — contracts, channels, technologies, processes, management quality, reputation, brand, and customer relationships. And if you were to look at a 20-year trend line, it's enormously upward-sloping in favor of intangible assets.

Intangible assets are exactly where marketing makes its largest contribution.

> *Breaking the customer franchise value formula down a little bit further, it's really a function of the number of customers a company has times the lifetime value of those customers.*

They help drive networking capital in the tangible fashion in the shorter term; in the longer term, they add to the intangible aspect of shareholder value by improving the reputation, brand, and customer relationships. But how can marketing be described in tangible dollars to help finance understand how to bridge the short- and long-term together?

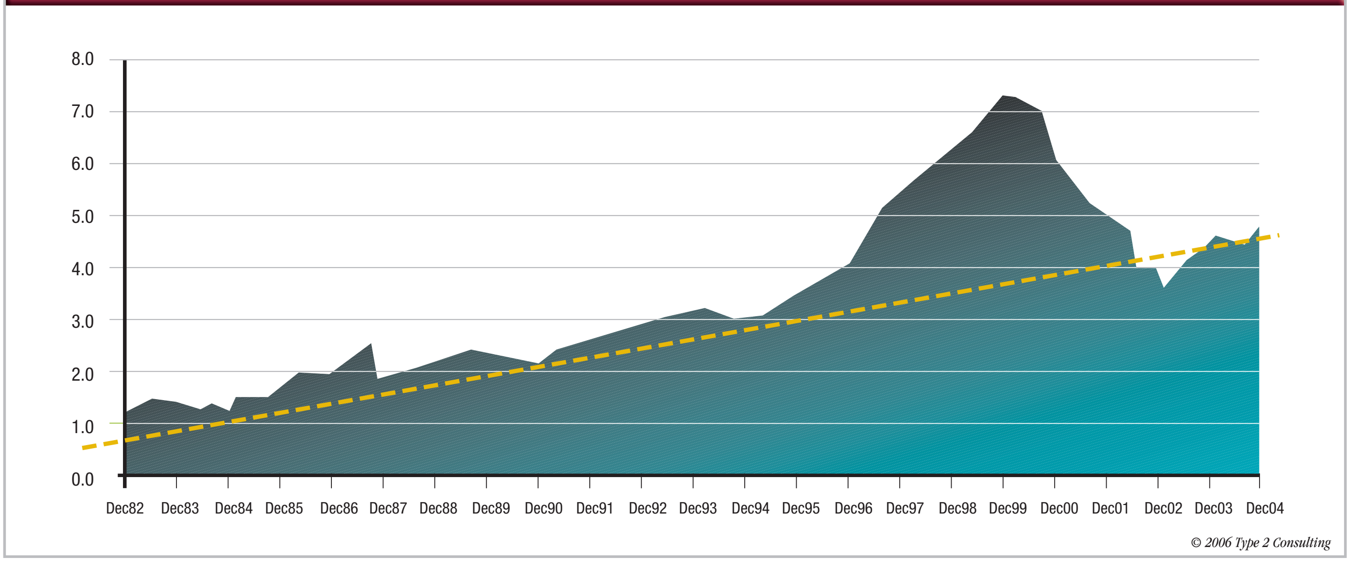
One way is on the basis of "customer franchise value" (CFV). CFV is a snapshot — the net present value of your current customer base, looking at how many customers you have, what they are buying today, how long they are likely to continue to buy into the future, your churn rates, etc.

Determining customer franchise value from this mix of variables requires a bit of patience and a few assumptions. Working with your colleagues in finance, you should be able to agree on some reasonable guesses for how customer value differs across segments, what the real retention (or churn) rates are, and which buying patterns create the most profitability. Simplicity is the rule of the day. Don't let the exercise get too complex too fast. It's far better to be generally right today than precisely wrong a month from now.

Breaking the customer franchise value formula down a little bit further, it's really a function of the number of customers a company has times the lifetime value of those customers.

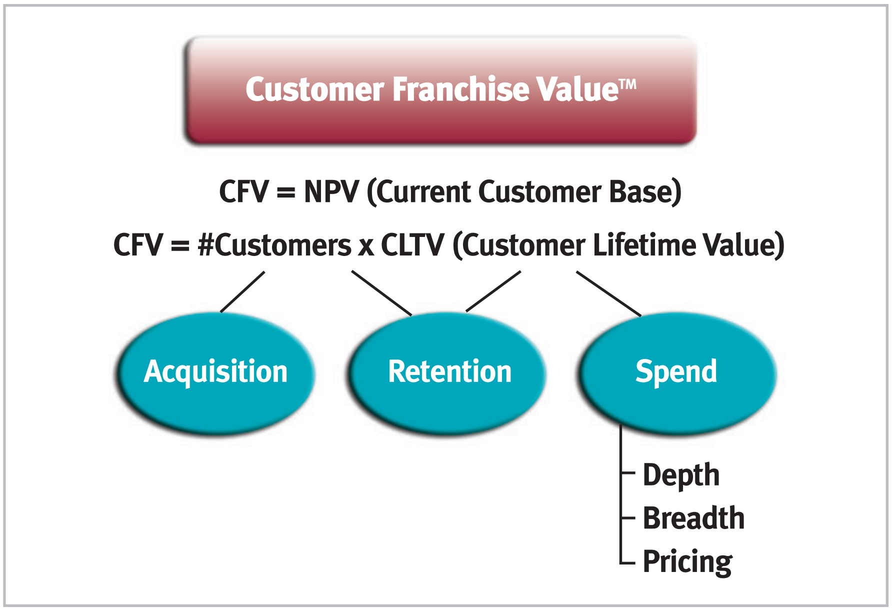
Again, it's important to emphasize that, for the purpose of building a bridge between short- and long-term financial impact of marketing expenditures, CFV does not involve potential value, or products and services a

S&P 500 — Market to Book Ratio (end month 12/82 to 12/04)



company doesn't yet offer that these customers might eventually buy. Rather, it refers to a very conservative present-value definition: What do customers buy currently and how long are they going to continue to buy it?

This customer franchise value breaks down even further into very simple components: the number of customers as a function of acquisition and as a function of retention. Retention is also a key factor in determining customer lifetime value, as are the dimensions, depth and breadth, of spend (or, put another way, the pricing leverage a company has in the marketplace).



So, interestingly, any marketing investment made that isn't purely a brand development investment covered by the previous structure is likely to be targeted at achieving one or more outcomes amongst some combination of acquisition, retention, and change in spend pattern. Everything done from a marketing perspective can be broken down into those three bubbles. As a result, every marketing investment that might potentially be made can be looked at in the context of how it would be expected to change customer franchise value.

For instance, how much customer franchise value will a company create this quarter, next quarter, and three or four quarters down the road? This is the beginning of a foundation from a financial perspective for helping finance understand when and how marketing investments are going to pay

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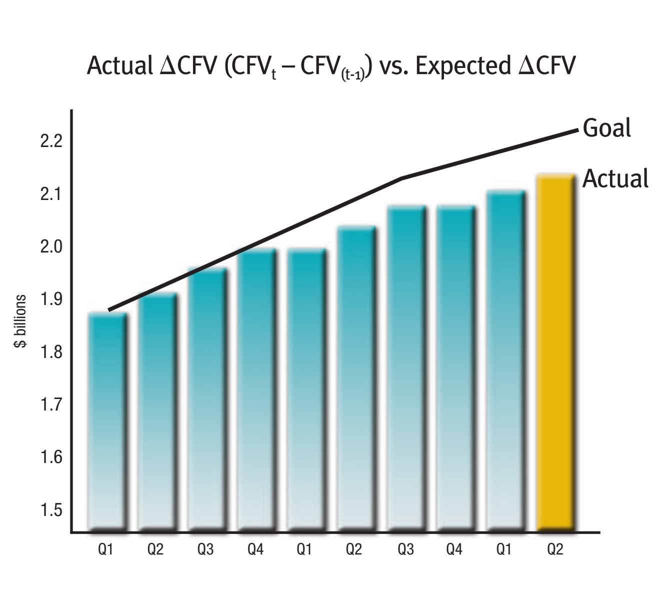
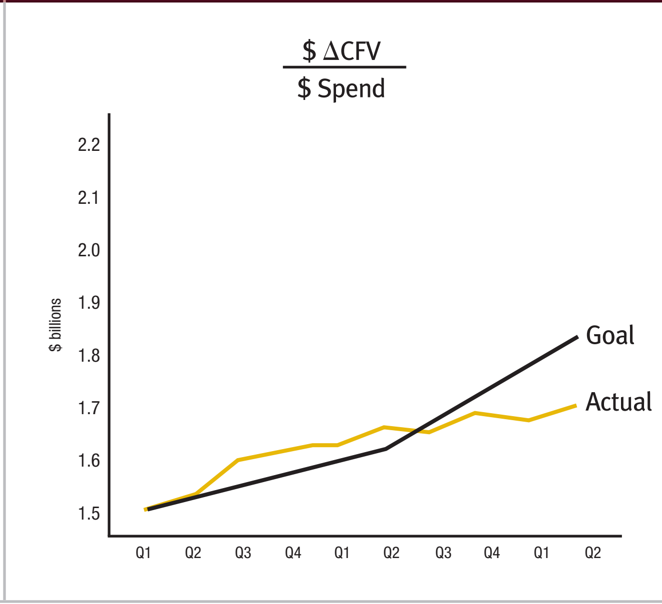
Effectiveness



Efficiency



back. But even more so, this provides a better framework for assessing what marketing effectiveness and efficiency are. Marketing effectiveness is a matter of looking at how the customer franchise value actually changed from one period to the next vs. how it was expected to change, and how marketing's actual results compare to projections.

> *Marketing effectiveness measurement is all about forming clear, specific expectations of what's going to happen, assessing the extent to which that particular reality was brought about, and understanding why it was or was not achieved.*

Marketing effectiveness measurement is all about forming clear, specific expectations of what's going to happen, assessing the extent to which that particular reality was brought about, and understanding why it was or was not achieved. Customer franchise value really helps achieve that goal, especially with regard to looking out into the future to accurately understand the benefit of spending money today.

CFV also helps from an efficiency perspective; in particular, in the context of how much CFV change was achieved per dollar of marketing spent. That's an efficiency metric that can be looked at across the board quarter in and quarter out, year in and year out, to gauge progress against expectation. Generally, it's not a slow, upwardly sloping line, because we all live in dynamic markets we've got to make adjustments for. But for marketers who understand the concept of an expectation of where we are going to be vs. where we actually are, marketing efficiency is really a question of how well a company's expectation is achieved.

Finance and accounting managers are not as interested in long-term value as they are in short-term value, so marketers need to put long-term value in terms that parallel short-term value and that finance can understand. Customer franchise value helps accomplish that task. Providing the CFO with CFV facilitates buy in, top-down acceptance, and budget commitment, all designed to help marketers achieve the long-term goals that drive future value, competitive differentiation, and solid growth.

Connecting Brand Value to Shareholder Value

A Q&A with Kevin Lane Keller

Kevin Lane Keller's book Strategic Brand Management *has long been the definitive go-to source for putting brand thought-leadership to practical use. The E.B. Osborn Professor of Marketing at the Tuck School of Business at Dartmouth College, Keller holds an AB from Cornell University, an MBA from Carnegie Mellon University, and a Ph.D. from Duke University. We asked Keller about some of the issues that surround the struggle in linking branding investments to financial value creation.*

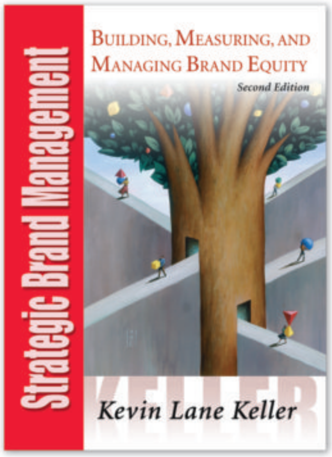
MarketingNPV (MNPV): ***Is brand equity a helpful concept in trying to link marketing to financial value, or does it cloud the issue?***

Kevin Lane Keller

Kevin Lane Keller: The challenge of brand equity as a concept is that it can take on many different meanings. One distinction I made early on in my work was separating customer-based brand equity from financial-based brand equity. I saw customer-based equity as being much more about brand health — about perceptions and how people see, feel, and act toward the brand, but not in financial terms or other types of measures. I saw financial-based brand equity much more as the consequences of those thoughts and feelings. So, one of the most important distinctions with brand equity is the way we talk about it. Both perspectives are useful. I encourage people to think about and measure both and to try to link the two. You'll never get to the root of marketing ROI and productivity unless you adopt both perspectives.

MNPV: ***It sounds like you're suggesting managing brand health from the consumer perspective creates a better probability of achieving the shareholder value.***

Keller: Yes, that's right and if you've seen the brand value chain model that Don Lehmann (Columbia University) and I have created, then you know that's essentially the path you follow. In a chain of events that occur, marketing programs and activities affect the perceptual measures, which in turn affect marketplace outcomes in financial terms, and then shareholder value. Managing brand health well puts you in a better position, but it's not automatic that shareholder value will result — there are factors that complicate things. But you can't get financial health out of something for nothing, so you have to do some good marketing in a broad sense — designing the right products; pricing, communicating, and distributing them the right way; and so on. The whole organization has to be aligned properly to achieve the right sequence of events that deliver the optimal customer experience -– to create those beliefs and perceptions that lead to those financial outcomes that show up in shareholder value. Having that sort of value chain of events in mind is helpful, because it makes clear what's involved and how things work together to create shareholder value.



MNPV: ***What have you seen emerging as better practices in working to understand the links?***

Keller: More academic research today is focused on shareholder value, and that's good. That wasn't the case 10 or 15 years ago, when shareholder value was seen as finance's domain. We're starting to see more research that looks at links between brand health measures and shareholder value. Look at the brand value chain and its four boxes: 1) marketing activity, 2) the customer mindset, 3) market performance, and 4) financial market outcomes and shareholder value. Companies tend to focus on the first three. The fourth one hasn't gotten as much attention. The belief is generally that getting the first three right — especially the first two — is going to lead to the right financial market and shareholder value outcomes.

But you'd better be trying to associate financial terms with all that marketing activity and brand health you're creating

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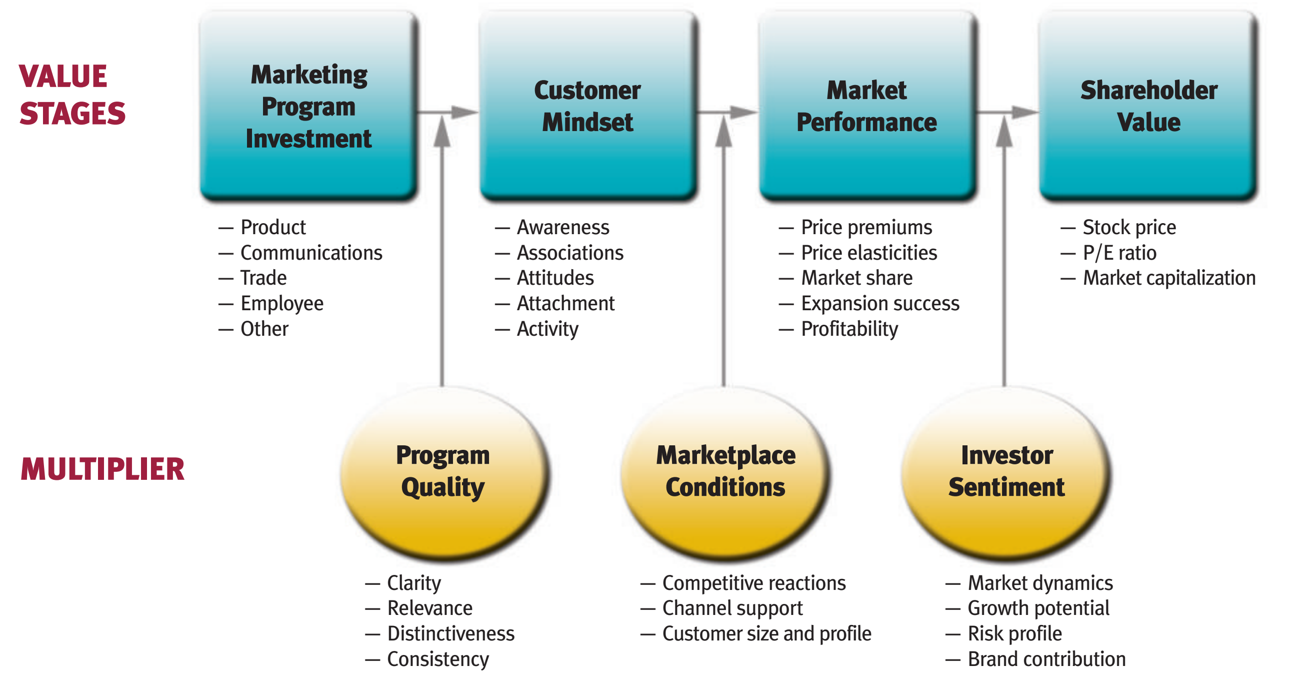


Adapted from Strategic Brand Management *by Kevin Lane Keller (Prentice Hall, 2003).*

to really understand what's happening to your bottom line and your whole financial profile. Taking that to shareholder value is great, but I'm most concerned that they get to that third box. That's important; that's one that a lot of people haven't done. That's still new territory — to link customer-based brand equity with financial-based brand equity.

Along those lines, I see companies doing a better job of creating the right battery of metrics to capture customer-based brand equity or customer mindset. Many companies are trying to develop more comprehensive and cohesive sets of measures. That's the right way to go. From that, you can develop more reductionist kinds of approaches. But in contrast, if you oversubscribe to the allure of simplicity of one or two "magic" brand measures, then that's where you're going to end up. It's tough for a lot of keen insights to emerge — not too many "whys."

MNPV: ***So you recommend starting with a broader diagnostic approach to properly identify the drivers and winnow it down to the real drivers over time?***

Keller: Correct. Any single item can be incorporated within the comprehensive system. The question is, how much value do you get from it? In some sense, the value of a comprehensive, cohesive set of measures that really capture customer-based brand equity and the customer mindset is that it gives you a lot of diagnostic insight into how things are really happening.

The second thing is the modeling side. One of the challenges in these correlation/causality situations is that you have so much going on. The systems of equations are horribly underspecified. To make causal statements ruling out alternative explanations confounds the situation. Absent some well-planned experimental approaches, it is practically impossible to make definitive statements about X causing Y — this ad campaign led to this consumer response — when there are so many things that went along with that campaign. But I see more and more companies working methodically to come up with better correlational insights, to find the patterns that are occurring, and to identify some hypotheses that are driving these trends. Those are the obvious areas people are trying to improve. It's important to have the right set of measures to play with though, and then to figure out the best way to estimate and understand those links — what's causing price premiums and market share profitability from these more perceptual measures and backing them up in terms of marketing activities that are occurring.

MNPV: ***So would you say that syndicated approaches like Y&R's BAV or CoreBrand help by providing a framework for pursuing this investigation, or do you think they're trying to find the golden shortcut?***

Keller: A lot of those are good, solid brand-health measures. If you had to grab one off the shelf and ask "What's the health of my brand?" they're going to help. The challenge is whether they've got enough diagnostics built in. Those are fairly reductionist tools.

BAV uses four key measures and a set of companion measures with a total of 40 attributes to provide insight. Back to the value chain model, the second box — customer mindset — is where these guys live. I don't know how much they can help their clients with the first to second box link or linking the measure of customer mindset to specific financial measures in the third box and making them part of the system as a whole. That requires a whole other set of models. No single syndicated tool is more than one piece of the puzzle. They are all really useful tools in the tool kit; you just have to have a full tool kit.

MNPV: ***Why aren't more brand marketers doing a better job of building the links? Are suppliers not offering the right solutions, or are marketers just not demanding that better solutions be developed?***

Keller: A big part of the challenge is the sheer complexity. You need some sophisticated researchers to help you sort through the puzzle. It's hard to get people who have enough of the skills to solve it all. To measure the customer mindset, all these market performance measures and shareholder value, the links between all the potential intervening factors — multipliers, filters, etc. — that's a lot to get your arms around. That causes many companies to shy away from the complexity and just focus in on reductionist solutions with the belief that those are going to be insightful enough.

Brand marketers need that R&D effort to calibrate, understand, and develop these measures to create a useful brand-health measurement system and the tool kit we're talking about. It's awfully hard for a brand manager who's making a million decisions every day to have that expert point of view and perform that function. I'd like to see organizations initiate the brand R&D effort through more of a top-down vs. bottom-up approach. Top-down approaches are necessary to really give enough of the time, energy, and resources to get to a critical mass of insights.

MNPV: ***Is it possible that CMOs, knowing they need to have impact fast and assessing the various places they might invest money and political capital, determine that they're better off getting lots of tactical initiatives in play than emphasizing diagnostic knowledge development and calibration?***

Keller: That's why I recommend the systematic top-down approach — because the CMO may not be there in two years. Even though the CEO may not have the necessary marketing skills, if the CEO makes it a priority, he or she can be an effective sponsor and can enlist the support of the CMO to lead the charge.

Then there's the whole question of multiple constituencies when we broaden our thinking and consider not just customers and prospects, but communities, analysts, shareholders, etc. This tends to be more directly the domain of the CEO.

Generally, I'm stunned at how hard it is to transfer fundamental learnings and generalizable insights within an organization and across markets. This is not rocket science; it's just trying to figure out the right way to capture the learnings and share them with the right people in the right way at the right time.

MNPV: ***Where do you think we're headed in our collective ability to develop better insights and make these links clearer?***

Keller: You're going to see continued interest in measuring marketing productivity, but most companies are going to have to come up with their own context-specific approaches. There's a great opportunity for researchers, agencies, marketing partners, etc. to assist with that. But it is always going to be tough to answer questions such as, "Should I spend $10 million on this ad campaign?" The answer is always "maybe," because the payback ultimately depends a great deal on a number of different factors.

Is the copy any good or not? How distinctive is this campaign? Does it connect with the audience? Is it inspiring? Does it actually convince people to buy or buy more or more often? The reality is, there's a lot of uncertainty; there's the art and the science to it. Everything that we talked about so far is the science side, but there's this whole other art side that's involved. We try to apply the science on top of the art, but we also need to spend much more of our energy and money to get to better insights into creativity and the artistic side of it all.

What to Cut: How to Pick Your Spots When the Budget Axe Is About to Fall

We've all been there before. Business is a little soft, and you are asked to start cutting the marketing budget so the company can make its year-end profit goal. To be overly dramatic, this is the marketer's version of "Sophie's Choice" and you have to decide which of your "babies" will go.

But what do you cut first? In the age of integrated marketing, how do you go about determining what is expendable when everything seems so important?

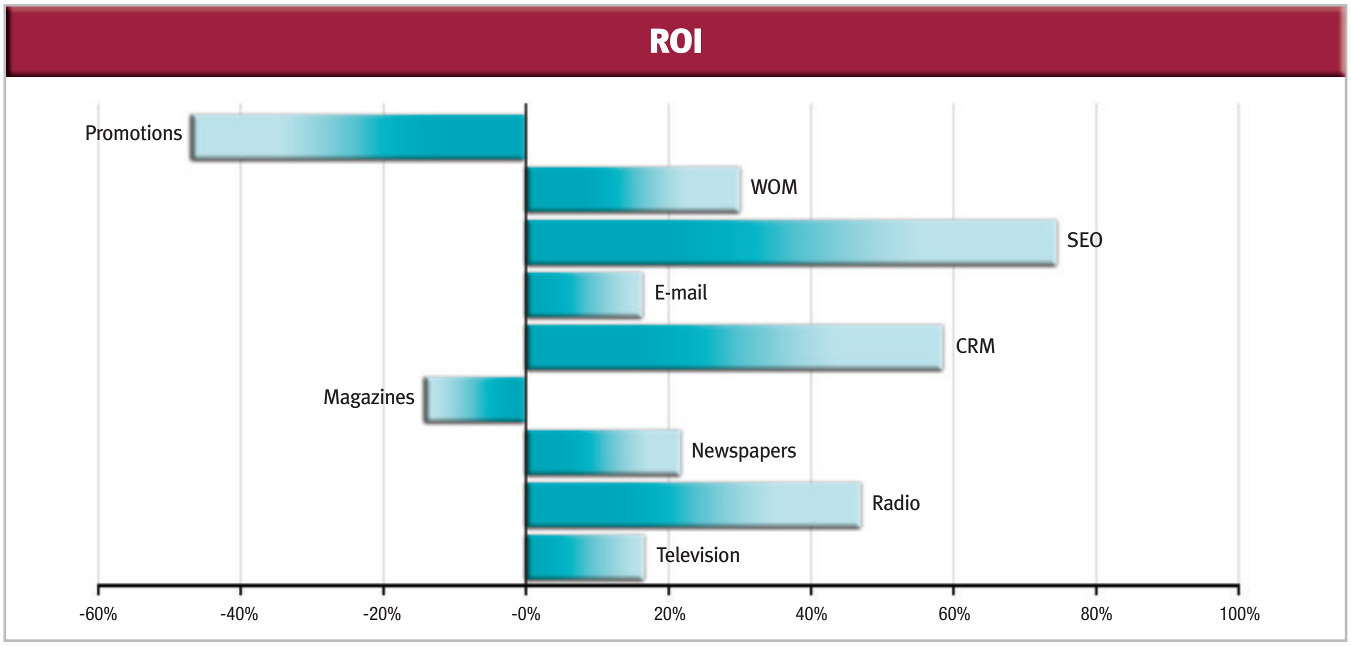
The Wake-Up Call

Before we answer, let's examine a fundamental assumption of the question. Assuming your company isn't in "burn-the-furniture-for-heat" mode, the request to start cutting is rooted in one of two perceptions in the minds of the CEO and/or CFO:

1. Your marketing does not provide a sufficient payback in the short run (i.e., this fiscal year) and nothing beyond that matters; or
2. You can't prove that it does.

In other words, they see the marketing activity as a discretionary investment and don't link it clearly to generating a specific (and sufficient) financial return. Or maybe they understand the concepts of brand equity and customer loyalty as having short- and long-term implications, but don't know how to assess the net present value of a dollar spent today in creating them.

The realities of today's business environment force short-term thinking and, as the CMO, you may not be in a position to do much about that (except maybe start building your measurement framework NOW so you won't be



asked to cut like this again next year). Face it: You being asked to cut is a warning sign that your persuasive charm and good looks alone are no longer sufficient to justify the money spent. If you can't prove the financial value of your marketing investments, you'll be dealing with this situation again, and soon.

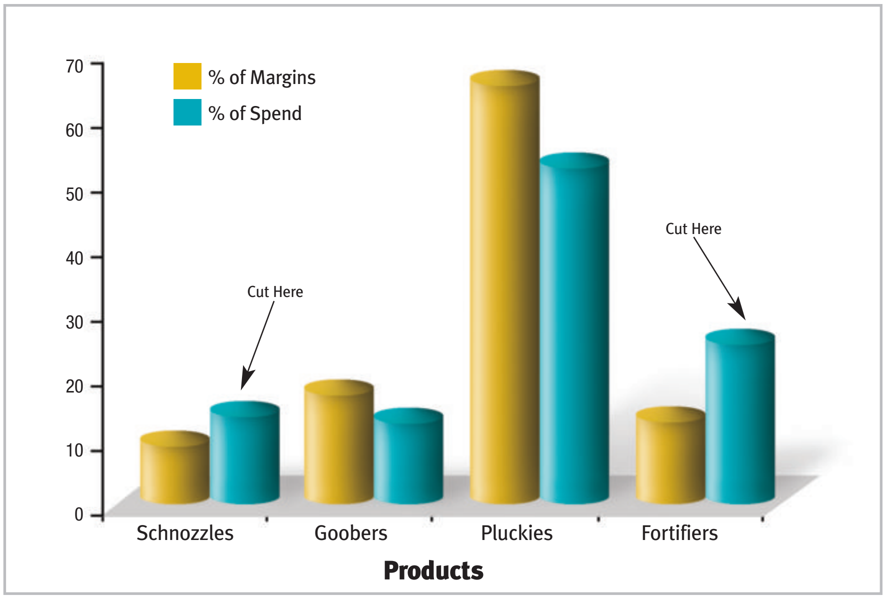
The good news is that the push toward marketing accountability has advanced the tools and methodologies available to the point where it is now quite possible to measure the majority of marketing activities. The argument that "it can't be measured" is just no longer a valid excuse. You can accept that statement either as another pain-in-the-ass part of your job description, or as an insurance policy against further short-sightedness on behalf of the marketing-challenged.

But enough of the soap box … How do we go about determining what to cut?

Not All Children Are Above Average

While you may feel that all your marketing programs are profitable, chances are that some are far less so than others. Having conducted detailed analyses on thousands of integrated marketing programs, I can tell you that the vast majority have some tactical elements that really work, some that clearly don't, and some that have to be tweaked to become profitable.

Step one in the process is therefore to determine what you already know about what is effective and what is not. What data exist that may point to a likely candidate for cutting? This



may sound like an obvious step, but I'm always amazed at how many companies knowingly apply the same levels of investment to particular marketing activities because "that is what we have always done," even in the face of strong evidence of its folly.

So if you find a sacred cow in your marketing pasture with no apparent justification for being there, that's your first candidate for lower investment. Use the mandate for cuts as an excuse to test lower levels of support. Challenge the owners of these tactics to develop a business case of the near-term financial cost of cutting the program. See what comes back and if it passes the sniff test.

> *"While you may feel that all your marketing programs are profitable, chances are that some are far less so than others."*

Avoid Saturated Fats

Often, we see companies putting the fat part of their marketing budget in a single tactical bucket, like automotive brands' use of TV, or Internet companies' use of online advertising. If you have more than 70% of your budget in any one item, alarm bells should go off. Time and again marketers using this strategy are found to be at or beyond the saturation level for their preferred tactic, resulting in diminished returns at increased levels of spend. These should be candidate areas for your cuts.

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Bigger Is Better

Fact: When you look at thousands of brand studies, financial returns on each dollar of spend tend to be greater for larger brands because of economies of scale.

If you manage a number of businesses (brands, SBUs, product lines), the ones that are smaller may have a disproportionate share of spending associated with them as they are trying to grow. Often, there are strategic reasons for this, such as launching a new product or putting up a competitive defense. But these same smaller brands tend to provide the company less return from their marketing activity and may be better candidates for near-term (especially temporary) cuts. That way you can show you're still optimizing the company's ROI in the near term based upon what spending you have left.

A related strategy is to focus the cuts on geographies where the brand is underdeveloped. Returns tend to follow a company's development in the market (this is a variation of the "bigger is better" rule). Cuts made in geographies where the business is weak will probably hurt less in the near term, but may also pose considerable expense in terms of successfully building the brand in those markets. This is a classic example of the tradeoff between short- and long-term investment decisions.

Timing is Everything

So far, we have talked about varying the level of investment and changing the marketing mix to address what to cut in the face of a budget whack. One other way to look for "what to cut" is to think about the timing of your marketing activities.

First, if there is a natural seasonality to your business, consider cuts in the off-peak periods. Activity in off-peak periods is rarely more efficient than when the highest seasonality occurs. It will also help minimize the risk to your overall annual plan, since less business will be at risk during those times.

Another variation on timing is to question the scheduling of the activity. For those of you with a media background, this is second nature. Examine the frequency of your marketing activities and look for ways that might minimize the total effect of the cuts. Can you vary the flighting of your activity? An example would be a retailer going to three weeks on and one week off for promotions rather than every single week.

A Good Offense Is the Best Defense

The aforementioned suggestions are strategies for dealing with a tough decision. They are intended to help answer with the question of what to cut in the absence of solid facts about what your marketing activity actually contributes.

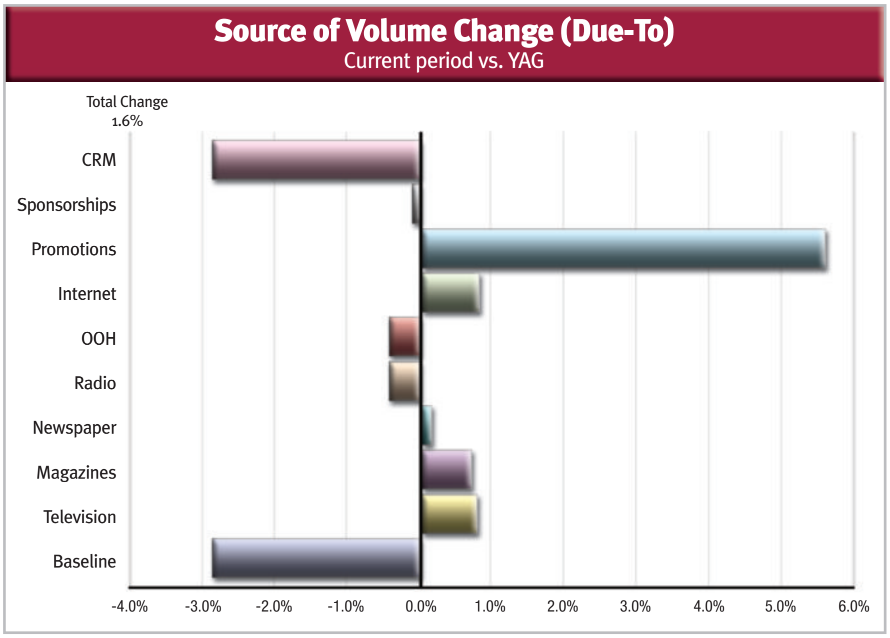
The key takeaway, however, should be that none of these approaches is even a close second to the option of proactively developing a comprehensive measurement structure that clearly demonstrates the links between each investment and the financial value it creates. Doing so will both reduce your risk and allow you to make more informed decisions on what to eliminate.

More importantly, it might just become the deterrent weapon to keep the CFO looking elsewhere the next time they're looking for givebacks.

Moving Beyond the Marketing-Mix Model

The marketing-mix model (MMM) has penetrated large marketing organizations to the degree that it has become a primary tool for assessing program effectiveness and tactical productivity, and an important element in determining overall payback on marketing investment.

Today, more and more companies are incorporating MMM directly into their shareholder value creation processes, extending its role beyond just the traditional view of periodic resource allocation to include guiding daily operations, building the links between marketing and corporate strategic goals, and tracking intangible asset creation.



Operational Guidance

Many performance management-oriented marketers are using "rapid-cycle" updates of their MMM to allocate incremental mix elements. Soft-drink marketers, for example, refresh their models monthly, allowing for week-to-week changes in marketing support planning. For example:

- Region A is short of its revenue target, but is far from saturated on radio, so more funds are allocated to radio promotions to drive performance closer to the target.
- Business Unit B is meeting goals, but certain tactics are proving to be unproductive, so that funding can be spent elsewhere or dropped to the bottom line without jeopardizing results.

Moving dollars like this on a quick-turn basis is only possible when the model has been broadly stakeholdered and senior executives trust that incremental or unallocated funds will go to the areas of greatest need. Absent that confidence in the tools, the politics of reallocation is likely to delay decisions beyond the acceptable timeframe for action.

Linking Marketing to Strategic Goals

Mix models are increasingly being used as a strategy support tool to help set revenue and margin goals tied to an optimal level of marketing investment. Instead of simply asking how to optimize the budget allocated to achieve the business goals, MMM is now being used to set the goals.

Granted, there are still many market and environmental risks that may weigh heavily on specifying those targets. But the impact of these effects can be more reliably simulated when they sit atop an already proven and carefully parsed assessment of the quantitative business drivers. In short, companies running effective MMMs have the ability to move far beyond the traditional forecasting approach of straight-line projections of historical top-line performance.

An added benefit to this approach is that business targets are inextricably linked to the investments required to achieve them. The result is a far lower likelihood to cut spending mid-stream to achieve bottom-line goals.

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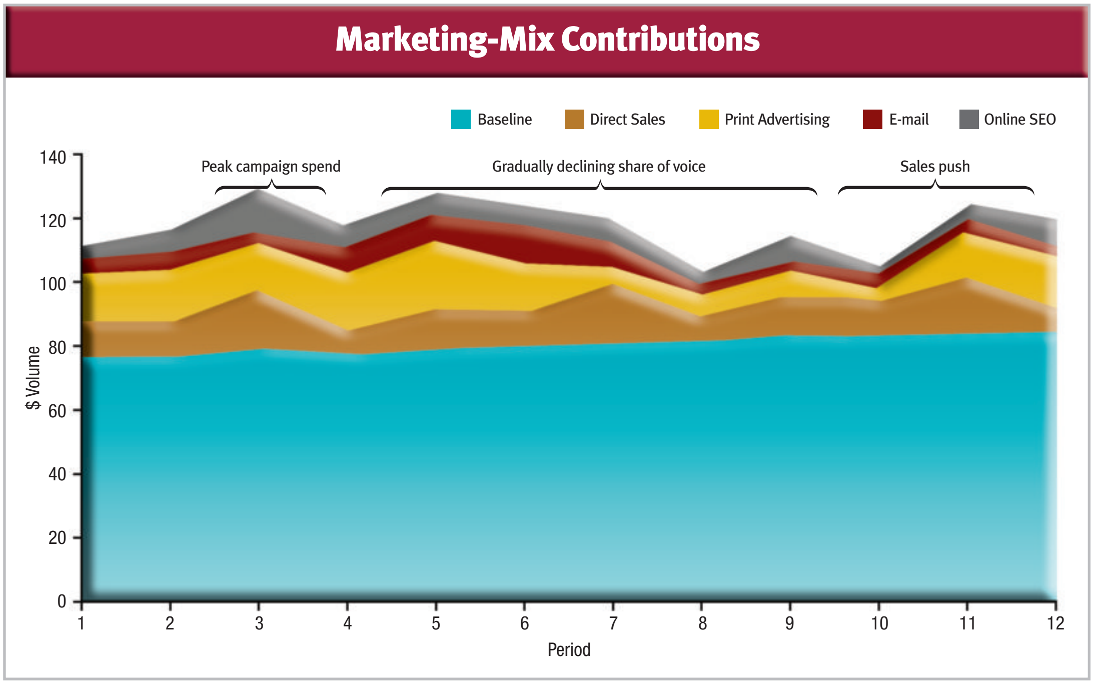
Building the Asset Base

MMMs are commonly used to monitor the impact of programs on generating incremental revenue over the "baseline" — that prominent portion of the business that is attributable to all the pent-up brand and customer equity value, and which would presumably continue to flow in even if all marketing were to cease for a brief period of time. However, mix models are evolving beyond their short-term blinders and emerging to be better tools for determining exactly how that baseline is developing.



By more closely examining the extent to which the benefits of established brands, loyal customers, and well-developed distribution networks work independently or together to create a predictable stream of future revenues, MMM can identify clear pathways to increase both the magnitude and sustainability of them. Valuing this baseline and tracking changes over time can help clearly demonstrate whether the company's marketing activity is creating asset value or just buying near-term results by tapping into its asset base.

MMM Cautions

Successfully extending the role of the MMM as described above requires an understanding of the traditional shortfalls of mix-modeling and some actions you can take to avoid them.

First, the assumptions and limitations of the MMM need to be well understood by the organization as a whole. As a black-box tool, it will be accepted only as long as the results do not suggest significant changes from the historical norm. The moment the MMM starts forcing decisions that result in reallocation of resources across political boundaries, questions about methodology, assumptions, and analytical robustness are sure to flare up.

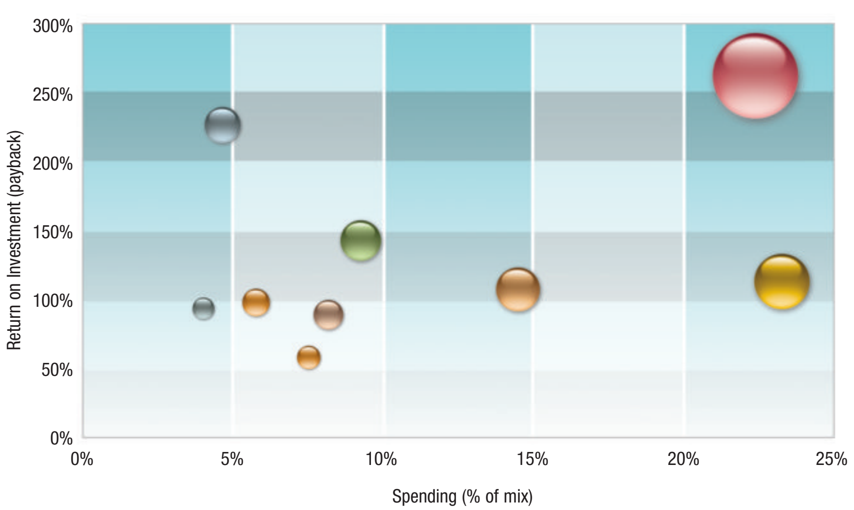
Laying the acceptance groundwork is as important (and challenging) a part of MMM as building the algorithms or collecting the data. Having key stakeholders and decision-makers (e.g., finance, sales, business units, distributors, etc.) participate in building the inevitable set of assumptions underlying the model may require more time and heartache in the near term, but will dramatically reduce the infighting down the road when the real important decisions need to be made fast.

Second, MMM is historically much more accurate at measuring the correlation between what goes in (spending) and what comes out (revenues or profits) than it is at breaking apart what actually happens in between in the marketplace. As a result, these complex models sometimes "break" when the external environment changes significantly in ways that were not anticipated nor programmed into the inputs and assumptions. Changes in the competitive environment (new entrants, new products, changes in pricing, or competitive communications) can disrupt the historical relationship between spend and response.

However, if the dynamics of the environment are embraced as key elements of the process and not strictly isolated statistically or ignored, "broken" models can generate great insights. These marketplace events are natural experiments that enable marketers to see how relationships between the variables work in extreme contexts, making the model more useful and trusted going forward. The presumption here is, of course, that the expectations for the MMM were properly set and agreed amongst all key constituents beforehand.

This gets to the third caution regarding use of MMMs. The model will, on occasion, fail. Expect it. Marketers who treat the model like an oracle, without understanding its limitations or regularly question its output, leave themselves vulnerable when results do not match predictions. This is especially important in organizations where the MMM has been deeply ingrained into other processes as discussed above. Those who are too wedded to a single tool, regardless of its utility, will eventually be seen as one-trick ponies. Then, when their trick fails, their usefulness immediately drops and their credibility may suffer irreparably.

Relationship Analysis
Investment vs. Efficiency



A Slice, Not the Whole Pie

Today's marketing measurement toolkit needs to be much broader than just MMM. Risk — both to the manager who "owns" the MMM and to the organization as a whole — is magnified by over-reliance on a single tool. Even more important for the organization, however, is the perception bias that comes from over-dependence. Someone who only has a screwdriver in their toolkit thinks every problem gets solved with a screwdriver — though a hammer, chisel, or crowbar would have been the better tool for the job at hand. The same goes for MMMs.

Often a well-designed MMM becomes the focal tool of choice, crowding out investment in other useful measures. Analytical tools focusing in areas of the business like sales-funnel progression or pricing elasticity, which may be built on data sets that are less mature or assumptions without third-party benchmarks, will struggle to compete with the MMM, at least initially. Deep understanding of brand drivers, customer behavior and value, loyalty triggers, innovation, and so on also depend on measurement and analysis outside of the mix model. These measures often need to be derived with non-econometric techniques like customer surveys, market research, mining of transactional data, and experimental designs linked to well-crafted and understood assumptions.

Trying to answer these questions and measure marketing's impact on them takes time and dedicated effort. Understanding the key questions facing marketing, then developing a stakeholdered and resourced action plan, is the first step. Building such a measurement framework is evolutionary, with some areas advancing more quickly than others based upon the availability of data and the skill sets present in house. With some areas, like MMM, the use of external resources can help accelerate maturation, but other areas will require careful tending over long periods of time before full benefits can be reaped. Quick wins are essential to maintaining momentum and proving value early on, but be careful not to let them be the only wins.

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