

PART V

STEP 4: ESTIMATING RETURN ON CUSTOMER INVESTMENT

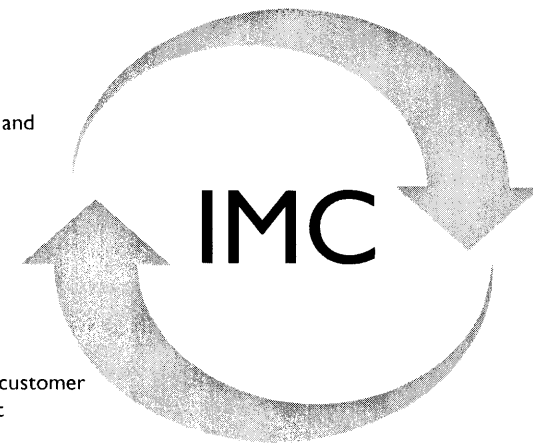
1. Identify customers
and prospects

2. Valuation of
customers/
prospects

3. Creating and
delivering
messages and
incentives

5. Budgeting,
allocation, and
evaluation

4. Estimating
return on customer
investment



BASICS OF IMC MEASUREMENT

One of the critical elements in step 3 of the IMC planning process was to ensure that all messages and incentives were capable of measurement because step 4 focuses on calculating return on customer investment (ROCI). We look first at traditional marcom measures, which are attitude based. Because financial measures are becoming so important, this chapter then helps familiarize marcom managers with basic principles of accounting and finance that will make financial measurement easier.

The days when marketers could dismiss the financial people in the organization as “bean counters” who restrained creativity are long gone. As shown in Chapter 5, traditional marketing efforts, which focused on changing attitudes, have proven all but impossible to evaluate in financial terms. Because IMC treats customers as assets and is directly concerned with behavioral returns on investment rather than attitudinal change, it is now possible for marketing to answer core financial questions, namely the following:

- How much should be invested in marketing communication?
- What type or level of return will be achieved from that investment?
- Over what period of time will that return occur?

These three questions are nothing new. Senior management has always wanted to know the level of returns they could expect from their marcom investments. Yet because it was so difficult to link increases in sales directly to marcom efforts, finance executives have tended to view marketing as a “soft” function, lacking accountability. The rise in direct response marketing and E-commerce—which result directly in sales to an intended audience—has resolved some of the return on investment mysteries that confounded management. But in large part, communication—which often accounts for the highest levels of spending—is still a gray area. This chapter helps marketers understand why and provides a new model that overcomes the obstacles to proper measurement of the marcom function.

Why Marcom Measurement Has Proven So Difficult

There are four main reasons why the results of marketing communication have been difficult to measure in the past. This section first looks at each and then considers how an IMC approach helps overcome them.

- **“Black box” of communication.** As the children’s game of Telephone illustrates, much is open to misinterpretation when any message is passed along from one person to the next. Everyone has taken down phone messages wrongly or added their own elaborations while retelling a story. This is because much of the effect of communication occurs inside the head of the person who receives it. As we discussed in Chapter 7, because of the way the brain processes information, people usually cannot explain what messages they have received, over what period of time, or what impact that communication had on their attitudes, much less on their behaviors. This is the “black box” of the communication process. Unless marketers can find a way to open the customer’s mental black box, they are left with surrogate measures of the impact of marketing communication.

The black box explains why many of the communication measurement techniques used in the past focused on factors that could be measured easily, such as the number or timing of media exposures,

areas of coverage, distribution of literature, and the like. The focus has traditionally been on *outputs*, measuring the messages the marketer sends out, rather than on *outcomes*, identifying the results of those messages in terms of impact on the marketer’s business. The IMC process reverses this situation by focusing on outcomes—changed behaviors that result from marcom activities—rather than outputs.

- **Time and timing.** Time is a major factor in communication measurement. Not every marcom message received by a customer or prospect, or even those that impact the customer’s or prospect’s behavior, results in an immediate response. That’s why in IMC, marketers separate communication types into messages and incentives. Messages work over time; incentives generally work quickly. Additionally, some marketers believe multiple exposures to the message or incentive are needed for the prospect to learn or understand the value of the product or service and thus make a favorable purchasing decision. In the IMC approach, the goal is to be in front of customers and prospects when they need and want marketing communication. That’s why the process starts with message delivery and then moves on to message content.
- **Source of message or incentive.** Customers and prospects are exposed to a large assortment of commercial messages from a wide variety of sources, ranging from television commercials to packaging to simple word of mouth. Untangling the source of messages and incentives is a major issue in determining the impact of marketing communication. Certainly, that is true when the marketer is attempting to determine which delivery system worked and which didn’t. Fortunately, new statistical techniques, such as marketing mix modeling (described in the next chapter), provide the ability to break out which communication tactic worked and which didn’t. These hold great promise for the future.
- **Those bothersome intervening variables.** Let’s assume a prospect sees a newspaper ad or television commercial and is influenced to seek out a particular product for purchase. To go through with the purchase, the prospect must first identify the local dealer or distributor for the product, then go to the outlet. Assume the convinced prospect (a) cannot find a parking place, abandons the search, and

buys another brand at another store; (b) goes to the retail outlet, but the desired model is out of stock—no sale; (c) finds the product in the store with a retail price much higher than that suggested by the manufacturer and purchases a competitive product at a perceived value price; (d) enters the retail outlet but finds the retail clerk unknowledgeable and unable to answer questions about the product—again, no sale; or (e) tries to navigate the company's website to place an order and finds the input system is so complicated that he or she abandons the shopping cart midstream. In cases like these, where the marketing communication obviously had a positive impact, can one really say it worked? Many marcom managers would argue that it did, even though no sale resulted. They would claim “success” based on effective communication. They would suggest that *intervening variables* entered the purchasing process and hampered what would otherwise have been a successful sale. While this argument has been used by marcom managers since the early 1960s, it is becoming less and less relevant today. If one agrees that marketing communication is the successful result of a combination of marketing and communication variables, the marcom manager must find ways to overcome these intervening variables. That commonly requires working with their internal sales, operations, logistics, and other departments to find ways to ensure the future success of marcom investments. Marcom managers can no longer walk away from the situation by claiming intervening variables. They simply must find ways to deal with them.

These four issues explain why marcom has, in the past, eluded effective measurement. Over the years, marketers have tried again and again to put measurement techniques in place. The section that follows describes some of these efforts while explaining why they are no longer appropriate.

Traditional Attempts to Measure Marcom Returns

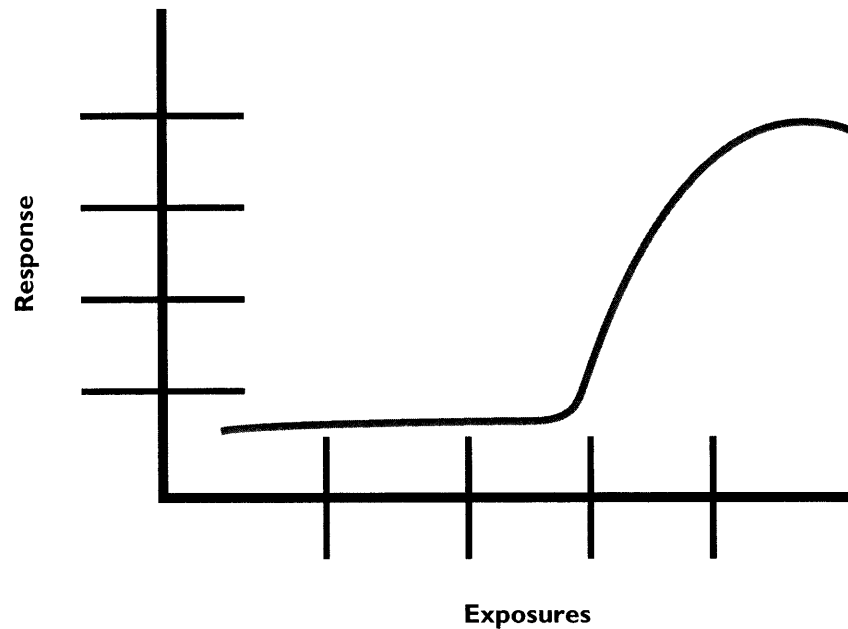
In the mid-1950s, as mass media developed and mass distribution grew, marketers and their ad agencies began to seek ways to measure the

returns on the ever-larger investments they made in broadscale advertising. Since products were sold through multiple channels, marketers became increasingly distanced from their actual purchasers. They needed an acceptable method of measuring the impact of mass advertising on their far-removed customers.

In 1961, two major approaches came to the fore. The first was the hierarchy of effects, which was explored in Exhibit 4.2. The second, developed by marketing consultant Russell Colley for the Association of National Advertisers (ANA), came to be known as DAGMAR, an acronym for defining advertising goals for measured advertising response.¹ Both models are based on the concept that consumers or prospects go through some sort of measurable, structured, and linear “attitudinal change process” on the way to making a product or service purchase. In short, they make the assumption that attitude change leads to behavioral change. As seen in Chapter 4, the hierarchy of effects took consumers from awareness to knowledge to hoped-for purchasing behavior. Similarly, DAGMAR moved customers and prospects through a hierarchical change in attitudes that were affected primarily as a result of advertising.

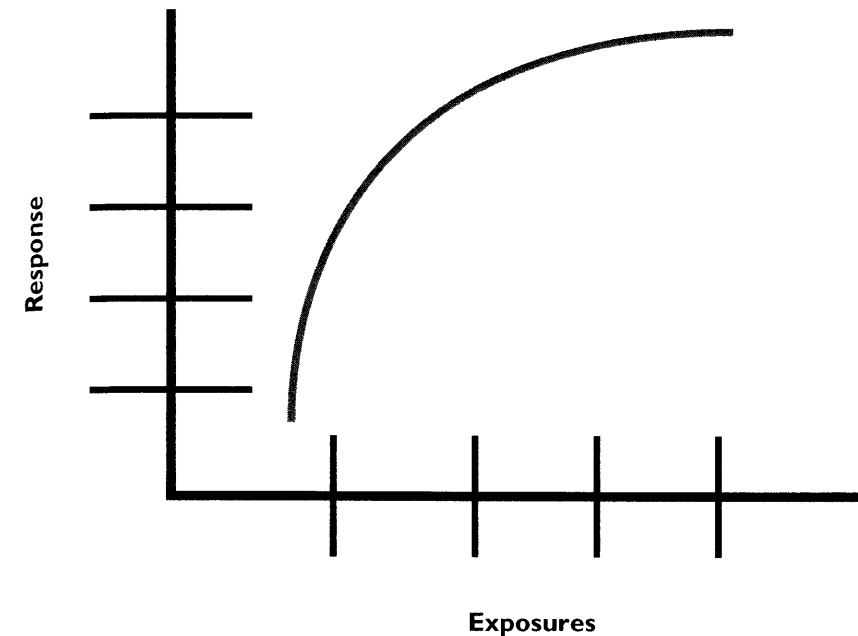
Thus, the hierarchy of effects and DAGMAR models both assume that advertising or marketing communication works to change customer awareness and attitudes over time as the consumer goes through a learning process. In other words, advertising is thought to inform or instruct, while customers, in turn, “learn” the marketer’s message. Both models further assume that multiple advertising exposures are required for the advertising to “work,” that is, for there to be behavioral change.

As a result, advertisers have generally subscribed to the premise of an *S-curve*, shown in Exhibit 9.1, as the basis of advertising response. Here, the number of advertising exposures are plotted on the x-axis, and the consumers’ response to the advertising, however defined, is plotted on the y-axis. The S-curve theory says, in effect, that there is little impact on the consumer in the first one or two exposures. At the third exposure, the advertising message is learned and the advertising impact occurs, whether the latter is defined as “preference” or “conviction” or even the elusive “purchase behavior.” Most advertising media planning and purchasing relies on S-curve assumptions, which are based on the hierarchy of effects and DAGMAR models.

Exhibit 9.1 S-Curve of Advertising Response

In recent years, however, new analysis of existing data, primarily developed by John Paul Jones and Erwin Ephron, has suggested that advertising may work in a different way.² The premise is that advertising can have short-term, immediate effects in addition to the long-term, brand-enhancing value traditionally ascribed to it. Jones and Ephron suggest that advertising works on the basis of *recency*. By that, they simply mean that advertising often has short-term effects in terms of influencing consumer behaviors, providing some support for the hierarchy of effects model. Thus, they subscribe to the recency model based on a convex curve—shown in Exhibit 9.2—in which the first exposure is the most important. So, the argument still rages on how advertising works, but progress is being made.

In support of this convex curve of advertising response, Jones and Ephron have used grocery store scanner data showing that consumers

Exhibit 9.2 Convex Curve of Advertising Response

who were exposed to—or had an opportunity to see—a television commercial for a particular brand during the preceding week were much more likely to purchase that brand than those who were not exposed to the commercial. In other words, recency—or the nearer the advertising exposure is to the point of purchase—may be of as much or more importance in generating actual sales than the frequency of advertising exposures.

Whether one subscribes to the recency approach to advertising impact or the more traditional frequency approach, there are inherent assumptions about the long-term impact of advertising exposures. As noted earlier, the real challenge in measurement is the time factor. During what period of time should one measure the results of marketing communication? The time factor is critical, since it is directly connected with how quickly the firm gets a return on its marcom investment. After

all, that is what management is concerned with: “How much did we spend? How much did we get back? How soon did we get it back?”

A Step in the Right Direction: Measuring Ad Stock

As a precursor to the emergence of value-based IMC planning and measurement, Simon Broadbent introduced a concept of advertising measurement that moves beyond just exposure or *opportunities to see*. Terming it “the measurement of ad stock,” Broadbent’s goal was to measure response to advertising over time.

Broadbent, a long-time researcher at the Leo Burnett advertising agency, defined *ad stock* as the combination of good feelings, attitudes, and experiences that customers and prospects build up about a brand over time.³ Ad stock, Broadbent suggested, has a major impact on whether or not a customer will repurchase a brand or become an advocate for it. By viewing a brand in terms of its ad stock, marketers are able to understand the long-term effects of advertising and other forms of marketing communication on purchase behavior. Over time, ad effects deteriorate, possibly through memory loss, exposure to competitive products and competitive advertising, and personal experiences. Thus, the goal of marketing communication becomes to maintain the ad stock or customer reservoir of good feelings, enabling the brand to remain a contender for future purchases.

Inherent in Broadbent’s concept is the idea of some type of lead and lag in advertising and marcom effects. In other words, some advertising likely works in the short term to generate immediate sales, and some is stored away and works over time—that is, from the ad stock base—by creating long-term behavioral effects.

While Broadbent and other researchers have focused almost entirely on the attitudinal changes that occur as a result of advertising exposure, IMC takes these concepts to a new level, arguing that there are surely both short-term and long-term behavioral effects of marketing communication. We refine the equation so that those effects can be measured in terms of financial returns to the organization, not just in terms of attitude change on the part of the consumer.

The Advent of Interactivity

Beginning in the early 1980s, direct marketing became a core element of marcom programs, particularly in the United States. Growing out of the areas of direct mail and catalog marketing, new technologies such as large-scale storage systems, databases, and statistical software brought a new level of expertise to the entire marketing field. With their aid, marcom managers could individually select the recipients for marcom messages and incentives. And, if successful, they would receive individual responses. But the big change was they were able to do both types of communication on a broad scale. Thus, many marketers began to precisely target their communication rather than simply using mass-media distribution systems in the hope of reaching appropriate customers and prospects.

Closing the Loop

For the first time in modern marketing, direct techniques enabled communication managers to “close the loop” on marcom investments and returns. As explained under guiding principle 6 in Chapter 3, the concept was simple. First, the marketer could individually select those persons he or she believed to be the best prospects for the marcom messages. In many cases, they proved to be present customers or those who had dealt with the organization before. The marketer first had to value the customer to enable some sort of intelligent investment decision. He or she commonly knew the cost of goods and the margins that would be available if a sale were made. The marketer could therefore calculate the cost to direct a specific communication program to the selected individual. Knowing the communication cost and the product margin, and estimating the delivery and service requirements, it was possible to determine the return on communication investment. This was done by knowing how many customers or prospects were contacted and how many responded with a purchase with what profit margin. In short, return on communication investment could be calculated following the completion of the marketing program, or with sufficient his-

torical data, estimates of future results could be determined equally well. In either case, the marketer could directly connect expenditures to returns. While there were still unknown factors such as uncontrollable competitive messages, economic changes, and the like that complicated the measurement process, for all intents and purposes, the investment and return loop could now be closed.

Also important was that if the customer response rate to marcom programs could be calculated based on numerous contacts and responses over time, historical and predictive models could be developed. Those models would then enable the marketer to determine the current response value of a customer and also make it possible to develop a series of hypotheses and models that could predict those returns in the future. Thus, the *lifetime customer value* (LTV) calculation was developed and still drives many direct marketing programs today. The LTV approach could be used to indicate how much a customer might be worth to an organization over a specific time frame.

Developing New Models

These newfound predictive capabilities enabled marketers to develop financial models that simply hadn't been available earlier. Today, marketers can estimate how much they would be willing to invest either to gain a new customer, retain or grow a present one, or get a customer to "trade up" from one product line to another using a portfolio migration approach. All of these calculations rely, of course, on a sound estimate of a customer's present value and potential future returns to the firm. Thus, it is easy to see the value of step 2 of the IMC process, in which such an estimate is made. This is key, for to plan effectively, the marcom manager must first know how much of the firm's finite resources to invest in various customers and then be able to estimate some type of return on those investments. Thus, organizations such as FedEx, USAA, Dow Chemical, Fidelity Investments, and Williams Sonoma can now actually operate on the basis of "marcom investments out" and rely on fairly accurate estimates or calculations of returns on marcom investments coming back in.

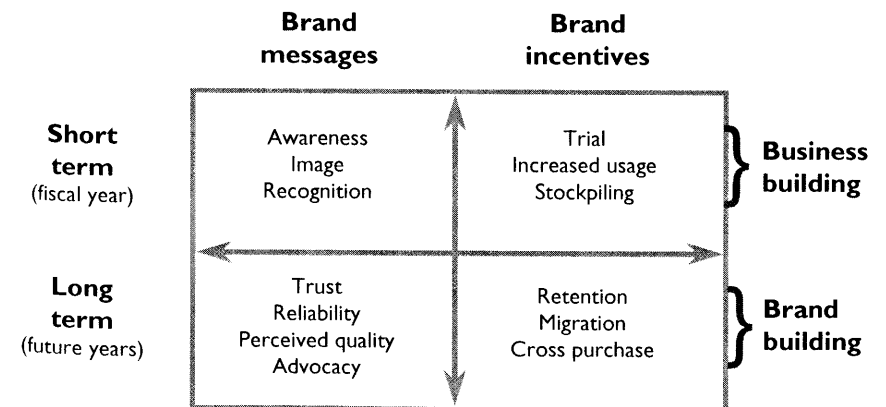
By now, the value of financial marcom models is clear. They give marketers the ability to move from relying on simple attitudinal measures of awareness, preference, liking, and the other steps in the hierarchy of effects to using reliable financial measures that show what the firm got back or is likely to get back from its marcom investments.

The ability to switch from attitudinal measures to behavioral measures and to deal with the lead and lag times that characterized traditional marcom methods sets IMC apart. More importantly, however, IMC clearly goes beyond traditional methods by recognizing the need for financial measures of marcom effects. The section that follows explains how IMC puts those measures in place.

Key IMC Financial Concepts

Step 3 of the IMC planning process introduced a communication planning framework built around messages and incentives. The next layer to that concept is added by considering the time frame in which communication responses are expected to occur. The matrix in Exhibit 9.3 separates the returns from the two core communication outputs—mes-

Exhibit 9.3 IMC Planning Matrix



sages and incentives—into those that are short term and those that are long term. Short-term returns come from those *business-building* activities that will generate revenues during the current fiscal year. Long-term returns are those that will accrue over more than one financial accounting period or fiscal year thanks to *brand-building* activities.

Each quadrant of the matrix contains examples of the types of marcom programs that generate each form of return. Brand message efforts that are expected to generate a short-term return include the kinds of activities typically associated with new products or rebranding efforts (increase brand awareness, establish a clear brand image, build recognition and preference). These efforts are supplemented with short-term incentive activities (gain trial, increase usage, get consumers to stockpile). All these message and incentive efforts work together to build sales volume and business during the current fiscal year and are measured against short-term criteria.

Messages and incentives have a role in generating long-term returns as well. For example, incentive programs frequently encourage long-standing customers to behave in a certain way. They are geared to increase retention, loyalty, upgrades (migration), or cross purchases. Airline loyalty programs are one of the best examples of long-term incentive programs that help build and enhance brands. Long-term brand messages address the timeless and enduring qualities of the brand, with an emphasis on the trust, reliability, or quality it represents. They are less strongly geared to attracting new customers and are heavily focused on creating passionate advocates from an existing customer base. These long-term message and incentive strategies combine to impact the asset value of the brand and are measured through techniques that value the brand in financial terms.

The matrix helps marcom managers treat marketing communication as a financial investment by viewing that investment clearly in terms of cash outlays and financial returns. Rather than planning their activities around a finite marketing budget ordained from above, IMC advocates that managers use a set of financial tools that allow them to manage income, outputs, investments, and returns, just like any other asset group within the firm. Only with such tools can marcom stop using meaningless measures, such as communication effects, and begin to get a grip on the real value and returns its activities provide the organization.

Cash Flows and Shareholder Value

In today's global economy, most organizations operate on the basis of two primary values:

- Increasing or stabilizing the firm's cash flows that provide the resources to conduct ongoing operations and to provide the flexibility to react to marketplace changes quickly and easily
- Increasing or improving shareholder value that, hopefully, will attract greater investor interest and provide greater access to capital (In most cases today, shareholder value is primarily a reflection of the share price or dividend policy of publicly traded firms or the retained earnings of those that are privately held.)

Generally, little else matters to the senior management of the firm. If they can increase, accelerate, or stabilize cash flows or increase shareholder value, they consider the firm—and themselves—to be successful. Thus, in the twenty-first-century marketplace, every marcom manager must find ways to relate these clearly defined management goals to the development and implementation of marcom programs. In other words, the marcom investments the manager makes must somehow deliver one of four values⁴:

- **Increase cash flows.** The general focus of marketing communication here is to provide ways of acquiring new customers who can provide new cash flows or to improve the returns on those customers the firm already serves (that is, to grow purchases and cash flows from existing customers).
- **Accelerate cash flows.** Since most firms operate on the basis of some type of *net present value* (NPV)—that is, money in the hands of the firm today is worth more than money obtained in the future—the goal of marketing communication here must be to accelerate the customer cash flows. For example, if marketing communication can reduce the buying cycle for an automobile from four years to three, the cash flow of the car manufacturer has been accelerated. Future cash flows become available sooner, giving the firm more flexibility and leverage.

- **Stabilize cash flows.** This is a major challenge to any organization. By having a stable cash flow, borrowing can be reduced, planning can be more strategic, and the peaks and valleys of financial turbulence can be removed. One way to stabilize cash flows is to enhance customer loyalty and continuity. If marketing communication can build loyalty, the cash flows to the organization can often be regulated and the overall results of the organization improved.
- **Build or enhance shareholder value.** Traditionally, shareholder value has grown because the firm owned or controlled valuable tangible assets. As companies have moved into the intangible economy with the resulting emphasis on cash flows and short-term earnings, the importance of marketing communication to build shareholder value has naturally increased. These values can be created by building greater perceptual value for the organization among financial analysts and the investment community. Another way is by building the image of brands and other intangible assets so they are perceived to have greater value than in the past. While corporate communication is often the tool chosen to attempt to increase shareholder value, marketing communication has a vital role as well.

Investments and Returns on Finite Corporate Resources

All organizations have finite resources. The purchase and distribution of various forms of marketing communication use up a portion of those limited resources. Funds not invested in marketing communication can be allocated to another activity, invested in assets, used to pay dividends, or held as cash in order to enhance profits and the balance sheet. Thus, the investment by the firm in a marcom program must be viewed as any other use of finite resources. It must provide some return to the organization. If marcom cannot provide the same returns as other investments, its use becomes questionable.

Concurrent with that is the need for marcom managers to understand that the organization's resources are limited. There is no corporate well into which management can dip to come up with funds to

support new communication programs. Marketing communication must be treated like any other investment and that means being able to justify the expenditure and having some idea of expected returns. Only in that way can senior management make intelligent decisions about marcom expenditures and investments.

Corporate Time Frames

Communication managers and communication activities work on a different time frame than does the financial system in the corporation. For example, commitments for advertising time or space may be made in the autumn of one year, but the advertising space or time is not used or billed to the firm until the spring of the following year. That may cross over two corporate fiscal years. The same is true for sponsorships that are made on the basis of multiyear contracts and even promotions that are initiated in one period but do not have an impact on the marketplace until they occur, resulting in cash flows in another financial time frame. Thus, communication is an almost continuous event or activity, whereas the corporation has clearly defined financial time frames.

Almost all organizations operate on the basis of a fiscal year, that is, 365 days of operation at the end of which the books are closed and the organization starts all over with a clean slate. True, financial commitments and obligations that cross over multiple financial periods are made, but these are unique situations and not the norm. It is this time factor, where communication is expensed in one period but the results are not obtained until a later period, that makes communication measurement and funding difficult. That's particularly true with brand-building investments.

From a financial standpoint, however, the organization has no choice. There are clear financial time frames, and marketing communication must be made to fit them. Thus, IMC takes a simple approach: use financial time frames and fit communication investments and returns to the accounting and financial standards on which the organization operates. It is simple but also challenging, given the impact and effect of marcom programs.

Net Present Value

The calculation of net present value has become a very important issue in the way organizations are operated and valued. Since organizations began focusing primarily on cash flows, or the net inflow and outflow of money, the focus of corporate management has shifted. Where once a firm was valued on the basis of tangible assets—that is, physical items or elements it possessed or could sell or that had marketplace value—today, this focus is clearly on how many “free” dollars or cash the firm generates that can be used in its operation.

Cash flows are interesting and unique elements. The theory that cash in hand today is worth more than cash promised at a future time drives many management decisions. Cash in hand today can be used to make investments, make purchases, or hire employees. Given the common assumptions of risk and inflation in the marketplace, estimates of future income flows are discounted at some rate to account for this current value of money versus its future value. Thus, organizations commonly value investments in terms of a *discounted cash flow* (DCF), or what the income or revenue might be worth in the future as a result of inflation, risk, and forgone interest or income over the time involved.

Since so many communication programs anticipate having an impact on future income flows to the organization, both in the short term and long term, NPV and DCF calculations become important elements in the IMC approach. They are explained in more detail in future chapters.

Brands as Assets and Investments

One of the key elements in the IMC process is the premise that the brands the firm owns are some of its most valuable assets. While it is true that brands are intangibles, they do have asset value. In truth, there are few things many companies control that have as much earning power or current marketplace value as their brands. Yet brands commonly are not managed as corporate assets. Instead they are too often treated as short-term investments in the hope that immediate returns will occur. Brand value builds over time. Brand returns come over time.

And brand marcom programs must be understood and measured as returns on investments over time as well. We discuss this concept of brands as assets and marketing communication as investments in more detail in Chapter 12.

Marginal Revenue/Incremental Returns

Marcom programs must provide a return to the organization. Ideally, that return will be greater than the cost. While there are some instances where the organization is willing to invest in communication in the hope of future returns, IMC must generally at least break even for senior management to consider it a viable investment. Thus, marketing communication, in the IMC approach, must generate greater returns than costs, certainly in the short term. We demonstrate this point in the next chapter.

Moving On

With this quick review of the principles of financial analysis in place, we are ready to apply these concepts to the measurement of returns from marcom investments. That is the goal of step 4 of the IMC process.