GETTING STARTED USING MARKETING METRICS

White Paper

by

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The cockpit of the 757 Boeing jet is a maze of ***instruments (analytic tools)*** *that produce* ***flight performance data (metrics)*** *that are critical to the safe and efficient flight of a 757. It would be impossible to fly a 757 without theses* ***analytic instruments*** *and* ***performance metrics****. Yet, companies invest millions or billions in marketing and sales strategies with no clear measure of their performance impact or efficiency.*

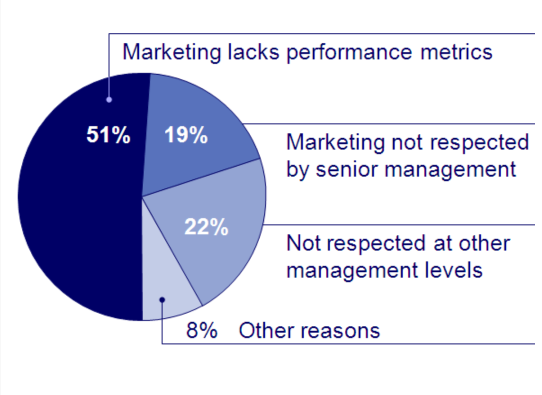
Most companies recognize the need for marketing metrics and the potential benefit they provide, but they struggle where to get started. A 2010 survey of 400 companies found that 75 percent recognized the need for marketing metrics, but only 25 percent had implemented a marketing metrics program (1). We will address the barriers companies and managers must overcome in order to successfully apply marketing metrics across their organizations. Before we address these barriers to getting started, let's first understand the need for marketing metrics and how they can be used to measure and manage marketing performance.

THE NEED AND IMPORTANCE OF MARKETING METRICS

Marketing has a responsibility to account for investments in marketing and sales strategies. We have found approximately 75 percent of a company's Sales, General & Administration (SGA) expense is invested in marketing and sales. For many companies this can be 15 to 25 percent of sales. Yet, marketing generally lacks the performance metrics to demonstrate the results produced.

A survey of CEOs conducted by Booz-Allen Consulting (2) showed that CEO's top concern about marketing was their lack of performance metrics, as shown in Figure 1. Marketing needs marketing metrics to demonstrate its performance as well as take a more responsible role in managing profits and profitable growth.

FIGURE 1: CEO CONCERNS ABOUT MARKETING



Marketing analytics are the tools needed to measure marketing performance and marketing metrics are measures of performance. Metrics and analytics are a big part of our lives, as shown in Figure 2.

Dr Roger J. Best is the author of Market-Based Management and was among the first to introduce Marketing Performance Tools (www.rogerjbest.com) in the first edition in 1996. Today MBM is in its 5th edition and is used in many corporations and top MBA programs. He is also the author of the Marketing Metrics Handbook (www.marketingmetricshandboook.com) which is an extension of his work in the area of metrics-based marketing management.

FIGURE 2: WHAT METRICS TELL US AND WHY THEY ARE IMPORTANT

ANALYTICS	METRICS	WHAT METRICS TELL US THAT IS IMPORTANT
Health		
Thermometer	**98.6**	Normal body temperature
Blood Pressure	**120/80**	Normal diastolic/systolic blood pressure
Pulse	**65**	Pulse rate is normal for my age and health
Automobile		
Gas Gauge	**25%**	Only 25 percent of gas left in the car
Speedometer	**63 mph**	8 miles per hour over the posted speed limit of 55
Pressure Gauge	**40 psi**	Tire pressure at the recommended level.
Marketing		
Market Dev. Index	**40**	Only 40% of the market potential has been developed
Customer Retention	**67%**	Losing 33% of our customers each year
Marketing ROI	**150%**	\$1.50 marketing profit per \$1 marketing & sales exp.


A body temperature (analytic) of 98.6 degrees (metric) tells us the body temperature is normal. We use our speedometers (analytic) to manage our speed (metric) in order to conform to the posted speed limits for different driving situations. Likewise, a marketing metric such as Marketing ROI tells a manager and company the marketing profits produced per dollar of investment in a marketing and sales strategy. If a company is investing billions of dollars in marketing and sales strategies, it is critical to understand the return on that investment.

MARKETING ANALTYICS AND MARKETING METRICS

Understanding the difference between a marketing analytic and marketing metric is the first step in utilizing marketing metrics. Marketing analytics are the tools and data that are used to produce marketing metrics.

A customer retention of 67 percent is a marketing metric derived from the following marketing analytic.

$$\textbf{Customer Retention} = \frac{\textbf{Customers Retained}}{\textbf{Total Customers at the Start of Year}} \times 100\%$$

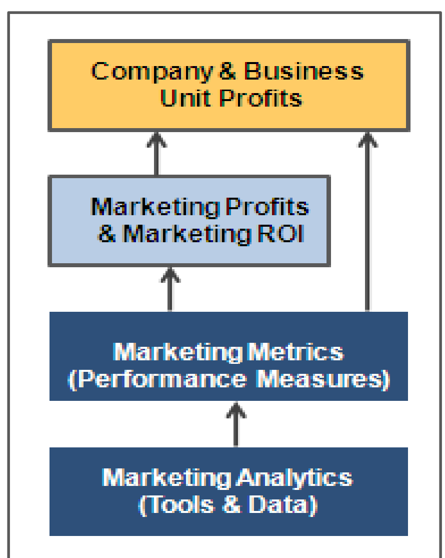
$$= 67{,}000 \;/\; 100{,}000 \times 100\%$$

$$= \mathbf{67\%}$$

This business retains 67 percent of its customer base each year. To maintain customer base of 100,000 they needed to attract 33,000 new customers each year. This is expensive since the cost of acquiring a new customer can be 5 to 10 times more expense that the cost of retaining a customer. If the company is able to improve this metric performance to 75 percent, they will reduce the cost of acquiring replacement customers by a considerable amount.

As shown in Figure 3, marketing metrics are derived from marketing analytics and are related to profitability.

FIGURE 3: MARKETING METRICS TRACK MARKETING PERFORMANCE and PROFITS



BARRIERS TO GETTING STARTED IN USING MARKETING METRICS

Many managers and companies recognize the importance of marketing metrics and their potential to better manage and report marketing performance. However, many managers and companies cannot get started for some of the reasons sited in Figure 4. For each barrier to usage we offer a recommendation on how to overcome that barrier and begin your usage of marketing performance metrics.

FIGURE 4: FIVE BARRIERS TO USING MARKETING METRICS

- **They are too complex and difficult to use**
- **They do not solve my business problems**
- **There are too many, I don't know where to start**
- **I do not have the data or the budget required**
- **I do not have the time for this type of work**

Barrier I: Marketing metrics are too complex and are difficult to utilize.

If a marketing metric is too difficult to use, it is not worth using. To get started, seek marketing metrics that are intuitive and make sense for your specific business operations. Some marketing metrics are complex and should only be added once you have had success using basic marketing metrics. For example, one large chemical company selected the following three marketing metrics because they had meaning to their business operations and they could be credibly presented to senior management: (1) Net Marketing Contribution, (2) Marketing ROI, and (3) Percent of Sales that were due to new products introduced over the past 3 years.

Barrier II: Metrics do not help us solve our business and marketing challenges.

What are your greatest business and/or marketing challenges? Once you have identified the critical areas for improvement, the question is – which marketing analytics and marketing metrics will help manage solutions to these challenges?

For example, a Dow Jones company needed a strategy to compete profitably in a price-sensitive segment that was larger than the premium and value segments where they were well positioned. Five marketing analytics were selected and applied to this segment challenge in five country markets. While each country strategy was somewhat different, the collective strategies projected a 59 percent improvement in profits following application of these five marketing metrics.

Barrier III: I Don't Know Where To Start – There are Too Many Marketing Metrics

Start with marketing profitability metrics. These basic metrics are the easiest to apply and will add the critical link to existing financial performance metrics.

"The reason for marketing's low level of credibility is largely because marketing lacks disciplined financial-return measures to assess the value of its contribution to the enterprise. (2) ***"***

Marketing needs credible, financial marketing profitability metrics that hold up under the scrutiny of senior management. We will present three marketing profitability metrics that you can apply to your business TODAY! These three marketing metrics will enable you to demonstrate the contribution your marketing and sales strategies make to the company and the efficiency of these investments with respect to a Marketing ROI metric.

Once your marketing profitability metrics are in place you can begin to explore other marketing metrics that will address major business and marketing challenges. The following resources will guide you in the search of marketing metrics that will address these challenges.

Marketing Metrics by Paul Farris, Neil Bendle, Phillip Pfeifer, and David Reibstein, (Wharton School Publishing, 2007) and related website www.MarketingNPV.com. (3)

Marketing Metrics Handbook (www.marketingmetricshandbook.com) Download a trail demo of this digital handbook and review the marketing metrics glossary. (4)

Marketing Performance Tools (www.rogerjbest.com) to review over 50 marketing analytics and marketing metrics available on-line at this website. (5)

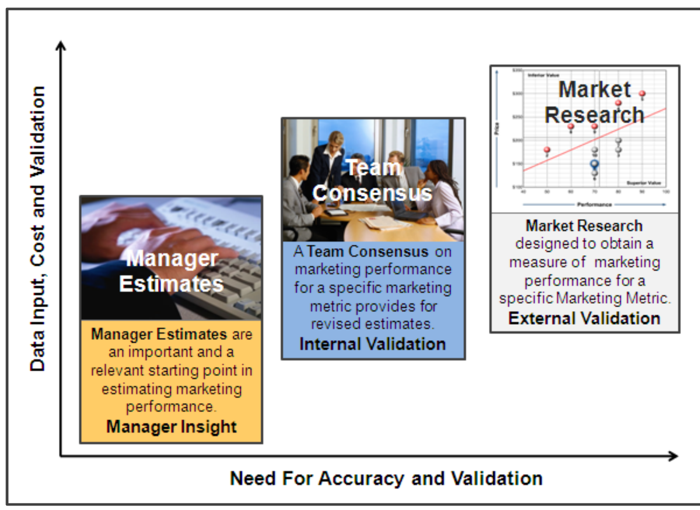
Market-Based Management by Roger Best. This book in its 5th edition presents over 100 marketing analytics and marketing metrics. This metrics-base marketing management book is available in English, Chinese, Spanish and Russian. (6)

Barrier IV: I Do Not Have the Requisite Data or the Budget to Acquire it

Manager insights and "best estimates" are the best place to start (3) and require no budget.

Management must remove the "fear of imperfect data," by beginning with informed estimates and hone data based on discovery. Early estimates can be easily revised with team consensus or market research if needed. Marketing analytics provide a way to capture the collective thinking of a marketing team.

FIGURE 5: OVERCOMING THE FEAR OF IMPERFECT DATA



Barrier V: I Don't Have the Time for This Type of Work

Managing marketing performance and profitability must be an important part of the job and responsibility of the manager. The following quote was taken from a product-manager after understanding how to use pricing metrics to better manage profitable growth and not just sales growth.

" Had we launched at a market-based price we could have increased our gross margin by $1.4 million. This block of instruction has really highlighted the importance of doing a price-volume analysis prior to launching a new product."

Marketing metrics are too important to be an add-on to the marketing and product manager responsibilities. They should be at the core of what they are measuring and managing. As the old saying goes, "if you can't measure it, you can't manage it." If you are being paid to manage marketing performance, it seems obvious that a manager should measure it.

WHERE TO START AND WHY

Many managers and companies recognize the importance of marketing metrics but find it hard to get started. Because companies use financial metrics to manage and evaluate performance, we recommend starting with three financially-grounded marketing profitability metrics.

There are many financial metrics that businesses use routinely, as shown in Figure 6. These are mainly internal performance metrics. Most marketing metrics are external performance metrics and forward-looking performance metrics. The three marketing profitability metrics, however, are internal performance metrics derived from existing financial data. The beauty of these three marketing metrics is that they can be measured at any level—the company, region, business segment, market, product line, product or large customer. Because these three marketing metrics use existing financial data they are easily understood across the organization with respect to accuracy and meaning.

Net Marketing Contribution

Marketing profitability is based on an investment in marketing and sales required to achieve certain levels of sales and gross margins. Net marketing contribution is a financial measure of marketing profitability and is computed as shown below:

Net Marketing Contribution = Sales Revenues x Percent Gross Margin - Marketing & Sales Expenses

Apple's net marketing contribution in 2009 was $10 billion, as shown below.

Net Marketing Contribution = $36.54 billion x 36% - $3.12 billion
= $13.15 billion - $3.12 billion
= **$10 billion**

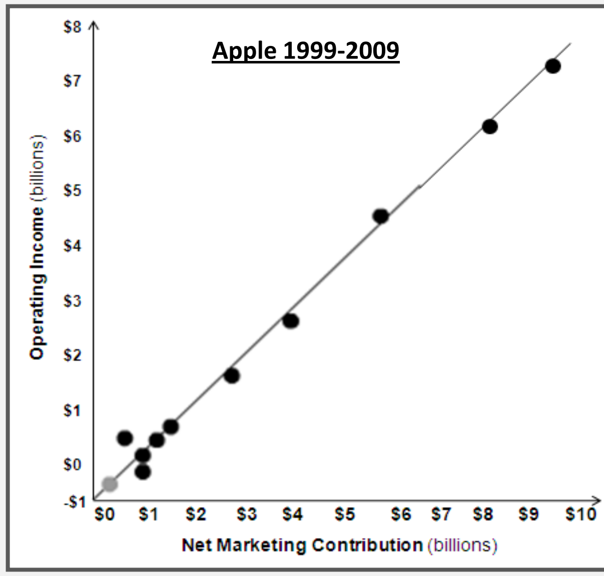
FIGURE 6: MARKETING METRICS vs. FINANCIAL METRICS

FINANCIAL METRICS	Performance
Profit Metrics	
Gross Profit	55.0%
Return on Sales	17.0%
Return on Assets	17.8%
Expenses Metrics	
Marketing & Sales Expense	21.0%
General Administration	8.0%
Other Expenses	12.0%
Asset Management Metrics	
Sales to Asset Ratio	1.05
Accounts Receivable	15.0%
Capacity Utilization	67.0%
Shareholder Metrics	
Return on Equity	15.0%
Return on Capital	13.0%
Earnings per Share	$2.00

MARKETING METRICS	Performance
Market Metrics	
Market Growth Rate	22.5%
Market Share	8.5%
Market Development Index	40
Customer Metrics	
Customer Satisfaction	64
Customer Retention	65.0%
Lifetime Customer Value	$45
Competitiveness Metrics	
Product Performance	11.0
Service Quality	-9.0
Customer Value	8.0
Marketig Profitability Metrics	
Net Marketing Contribution	$156
Marketing ROI	162%
Marketing ROS	34.0%

FIGURE 7: APPLE NET MARKETING CONTRIBUTION VS. OPERATING INCOME

APPLE 2009	
PERFORMANCE	**APPLE, INC.**
Sales	$36.54B
Percent Gross Profit	36.0%
Gross Profit	$13.15B
Marketing & Sales Expenses (%)	8.6%
Marketing & Sales Expenses	$3.12B
Net Marketing Contribution	**$10.03B**
Gen. & Admin. Exp. (%)	2.8%
Other Expenses (% Sales)	3.6%
Operating Income	$7.66B
Interest & Taxes (% Oper. Inc.)	25.6%
Net Profit After Tax	**$5.70B**
Earnings Per Share	$6.29



Apple's net marketing contribution had a high correlation (.94) with operating income from 1999 to 2009. Apple's net profit was also influenced by its net marketing contribution:

Net Profit = Net Marketing Contribution - General Expenses - Other Expenses - Interest & Taxes

= $10 billion - $1.0 billion - $1.2 billion - $2.0 billion

= **$5.7 billion**

Marketing & Sales Expenses

Marketing and sales expenses are an investment in product-market strategies and include many non-marketing expenses such as product management, customer service, sales and sales management. If a business exits a product-market, these expenses will disappear since they are expenses incurred given the collective efforts to serve a particular product-market.

One challenge you will likely encounter is in determining the actual marketing and sales expenses. Most companies do not report marketing and sales expenses separately, as they are wrapped into Sales, General & Administration (SGA) expenses. If you do not have this data, 75 percent of SGA is a good place to start. This estimate is based on a sample of companies that report marketing and sales and general administration expenses separately. One of the most compelling benefits of this marketing profitability metric is that it affords additional visibility to the return on marketing investments to those in non-marketing roles.

FIGURE 8: MARKETING & SALES EXPENSES

Company	SGA (% Sales)	M&SE (% Sales)	M&SE (% SGA)
Adobe Systems	39.9%	31.1%	78%
Campbell's Soup	22.1%	14.5%	66%
Cisco Systems	27.3%	21.2%	78%
Microsoft	29.5%	22.5%	76%
Oracle	23.0%	19.0%	83%
Average	**28.4%**	**21.7%**	**76.0%**

Marketing & Sales expenses should include all marketing, advertising, sales, service and support, as well as product management expenses associated with the marketing and sales of company products.

It should not include general administration expenses, R&D expenses or other expenses unrelated to the marketing & sales of company products.

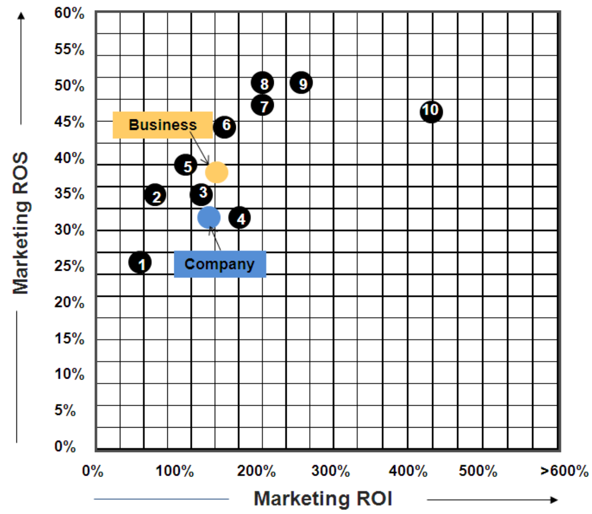
Marketing Return on Sales (ROS)

Ratio metrics allow businesses to compare their performance to other companies, as well as other business segments within the organization.

Marketing ROS is a simple marketing profitability metric that allows a business to compare performance across their organization as well as other publicly traded companies. Shown below is Apple's 2009 Marketing ROS. This ratio indicates that their 2009 net marketing contribution was 27.5 percent of sales.

Marketing ROS = Net Marketing Cont. / Sales
= \$10.03 billion / \$36.54 billion
= **27.5%**

FIGURE 9: MARKETING PROFITABILITY PORTFOLIO



Marketing Return on Investment (ROI)

Marketing ROI is another important marketing profitability metric. It is simply the net marketing contribution divided by marketing and sales expenses. When Apple's 2009 NMC of \$10 billion is divided by their \$3.12 billion investment in marketing and sales (M&SE), a Marketing ROI of 325 percent is produced. This means that Apple strategies collectively produced \$3.25 in net marketing contribution for every dollar invested in marketing and sales.

Marketing ROI = Net Marketing Contribution / Marketing & Sales Expenses
= \$10.03 billion / \$3.12 billion
= **325%**

We can create a Marketing Profitability Portfolio using Marketing ROS and Marketing ROI, as shown in Figure 9. This sample portfolio is for a business unit within a large medical devices company. The business unit averages for Marketing ROS and Marketing ROI are higher than the company average. This is useful information at the company level. The Marketing ROS and Marketing ROI for the ten major product lines help managers understand the relative profitability when comparing product lines across the business unit.

We can benchmark Apple against peer companies based on Marketing ROI and Pre-Tax Return on Assets (ROA), as shown in Figure 10. Apple had the highest Marketing ROI and second highest Pre-Tax ROA. We can also see that companies with a higher Marketing ROI generally produce a higher Pre-Tax ROA .

Figure 11 presents a broader view of this relationship for a large sample of Fortune 500 companies. The average Marketing ROI for this sample is 152 percent and average Pre-Tax ROA is 9.5 percent.

FIGURE 10: MARKETING ROI vs. PRE-TAX ROA

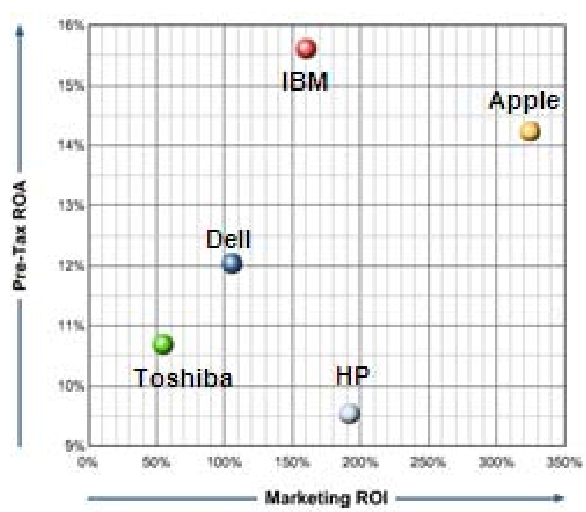
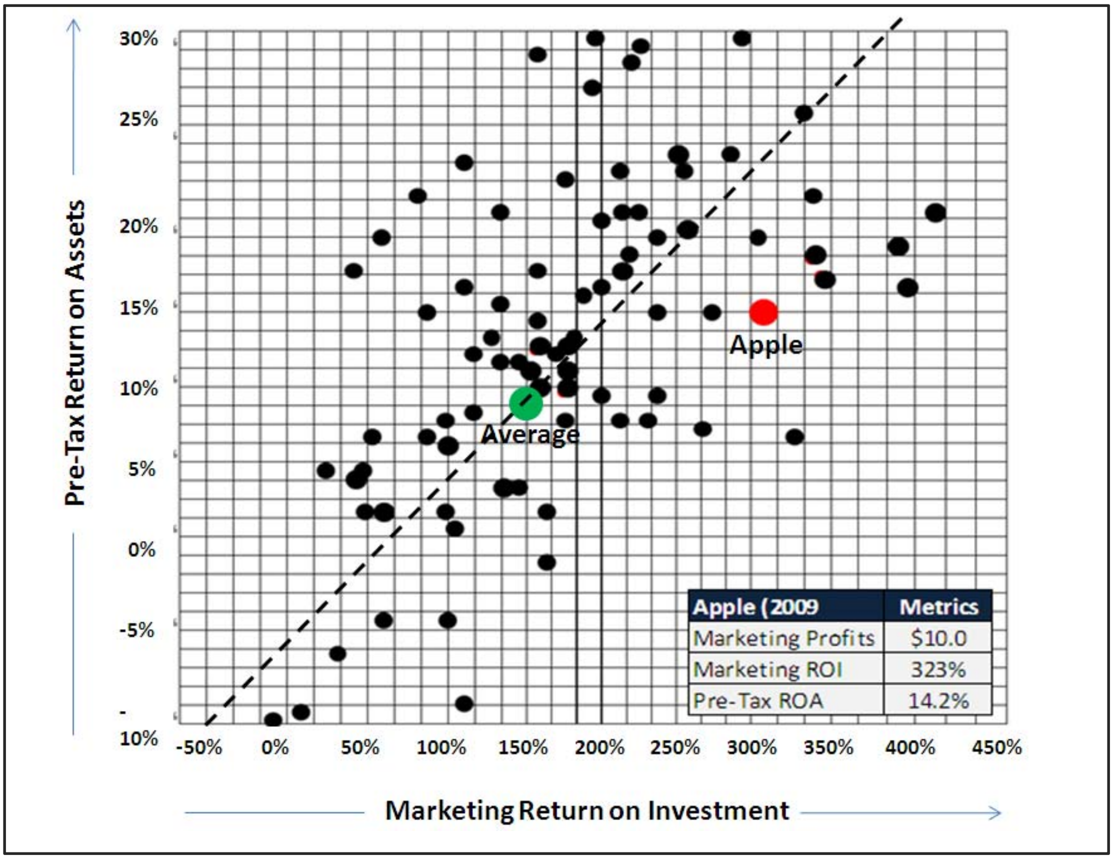


FIGURE 11: MARKETING ROI VS. PRE-TAX RETRURN ON ASSETS



Apple is considerably higher in both. While some companies with low Marketing ROI produce above-average Pre-Tax ROA, companies with above-average Marketing ROI were more likely to produce above-average Pre-Tax ROA.

COMPANY CASE STUDY

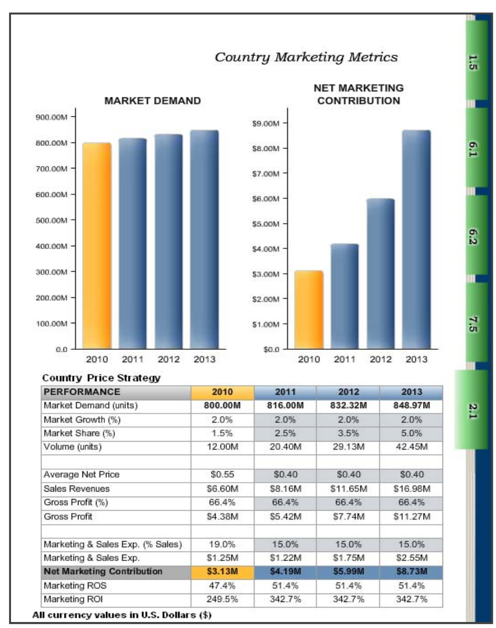
Business Challenge – A multi-billion dollar company struggled to find a profitable strategy for serving a price-sensitive market segment in Latin America for one of its major product lines.

Marketing Metrics – Six marketing metrics were selected from the *Marketing Metrics Handbook* to address this business challenge.

Program – Country managers were coached in Spanish with two web-based sessions and individual coaching in applying these marketing metrics to their country markets.

Profit Impact – Country pricing strategies along with projected profit impact were individually presented to regional management. The average projected country increase in net marketing contribution was 59 percent.

FIGURE 12: PROBLEM-FOCUSED MARKETING METRICS APPILCATION – COUNTRY EXAMPLE

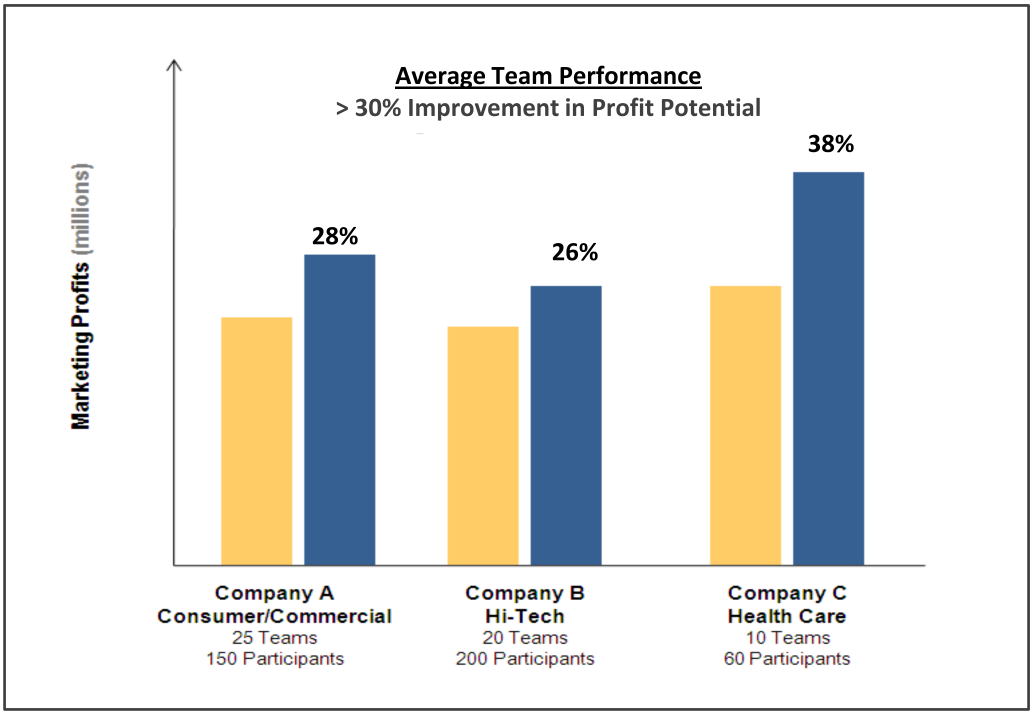


Country Price Strategy

PERFORMANCE	2010	2011	2012	2013
Market Demand (units)	**800.00M**	**816.00M**	**832.32M**	**848.97M**
Market Growth (%)	2.0%	2.0%	2.0%	2.0%
Market Share (%)	1.5%	2.5%	3.5%	5.0%
Volume (units)	12.00M	20.40M	29.13M	42.45M
Average Net Price	$0.55	$0.40	$0.40	$0.40
Sales Revenues	$6.60M	$8.16M	$11.65M	$16.98M
Gross Profit (%)	66.4%	66.4%	66.4%	66.4%
Gross Profit	$4.38M	$5.42M	$7.74M	$11.27M
Marketing & Sales Exp. (% Sales)	19.0%	15.0%	15.0%	15.0%
Marketing & Sales Exp.	$1.25M	$1.22M	$1.75M	$2.55M
Net Marketing Contribution	**$3.13M**	**$4.19M**	**$5.99M**	**$8.73M**
Marketing ROS	47.4%	51.4%	51.4%	51.4%
Marketing ROI	249.5%	342.7%	342.7%	342.7%

All currency values in U.S. Dollars ($)

FIGURE 13: TEAM PROFIT IMPACT WHEN APPLYING MARKETING METRICS



BEST PRACTICE – TEAM-BASED ACTIONABLE LEARNING

We have found that team-based actionable learning produces the best results when applying marketing metrics to a business. This allows for group learning and discussion with respect to estimates and assumptions around real business challenges. The yellow bars in the chart above are the average team estimates of net marketing contribution before applying a marketing metrics strategy to their business application. The blue bars are the net marketing contribution the average team could potentially achieve in three different companies when using marketing metrics. Across 55 teams represented above, the average increase in projected improvement in net marketing contribution was over 30 percent.

SUMMARY

While most companies and managers recognize the need to use marketing metrics and the potential benefit they can provide, many have found it difficult to get started. We have addressed five common barriers to getting started and recommend starting with three marketing profitability metrics. Once these basic marketing metrics are fully mastered, a business should seek to add only the marketing metrics that will help solve real business challenges. It is important to remember that it is not the number of marketing metrics that you use, but the effectiveness with which those that you select are applied across your business.

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