Marketing for the Bottom Line

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That Wal-Mart, the low-cost mass retailer, and BMW Group, a high-end automaker, can have anything in common seems improbable. But they do. Both companies have figured out a way to put a long-term value on their customers, and are able to more effectively direct their marketing investment than most companies, says Wharton marketing professor David Reibstein.

While the German automaker has calculated the value of its customers through a general formula, and as a result is in a position to direct a significant amount of investment to acquire a new customer, Walmart.com, the online division of Wal-Mart, has leveraged its consumer tracking tools to work out even more precisely what the value of each of its customers is.

"They (Walmart.com) know when they put Valentine's Day flowers on sale how much it costs to send that message, what percentage of customers end up on that site because of that message, how much money they will spend, and what is the likelihood of that customer coming back and buying other things," says Reibstein. They don't simply look at one-time purchases, but at all the purchases afterwards, and use that information to calculate the value of spending advertising dollars. "They have that down to a science for almost all of their advertising."

But companies like BMW and Wal-Mart are few and far between. Most companies routinely neglect the long-term value of marketing investment and thus do not acknowledge the lasting value of acquiring a customer. Instead, they adopt a "here and now" policy with regard to marketing dollars, says Reibstein.

Looking at the Long Term

A central message that Reibstein wants to convey to both finance and marketing executives is that it is a huge mistake to treat marketing investments as short term. He advises finance executives not to hold marketing accountable for what happens in year one, but instead view marketing costs as a longer term investment that has an impact over time. "There is a lot to gain in trying to measure and capture what the long-term value is," he says. "And that is where I think the failure has been. We have not done a good job of capturing that."

General accounting rules require marketing investments to be treated as a short-term expense, which is the primary reason that most companies focus narrowly on the short-term revenue generated by marketing dollars. "Almost all other investments that a firm makes are treated like [long-term] investments," says Reibstein. For example, when a company builds a plant it is depreciated over time, and if it has investments in research and development they are amortized over the useful life. "If you looked at either one of those types of investments and tried to evaluate the value of doing them, you

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would always come up with a negative return."

Reibstein says few companies make use of the tools available to measure the long-term value of a customer, and there is not enough understanding and interaction between finance and marketing departments to develop this concept. "I think a perspective and philosophical change is absolutely essential for companies" if they want to make the most efficient use of marketing investments, he adds.

Measuring Intangibles

An important step in that direction is quantifying the value of a firm's key intangible assets, which are mostly marketing-related such as brands, customer base and customer loyalty.

A common metric that companies can use to assess the long-term value of customer acquisition costs is lifetime value, which is the present value of all future profits generated by a customer. While a simple formula involving customer retention rate, acquisition costs, profit margin and discount rate will produce that value, it is the concept of a lifetime value that needs to be recognized, says Reibstein. Even a small percentage of increase in retention rates can raise profits considerably, depending on the other variables.

Reibstein points to PepsiCo, the soft drink maker, as another company that has recently assessed the long-term value of its customers. The company concluded that its number-one drink is Diet Pepsi rather than regular Pepsi, and that is where it is directing its marketing dollars, he says. "If you do some of the analysis, you will find that diet drinkers are much more loyal than non-diet drinkers, and that leads you down the path of putting greater emphasis on [the former] because loyal customers translate into long-term sales, which translates into a longer term customer value."

Another important intangible that companies tend to ignore is branding, says Reibstein. "Most companies do not go out and measure their brand's long-term value." Advertising dollars may not lead to immediate sales, but they may shift some consumer attitudes that could subsequently lead to sales, increase the lifetime value of an existing customer, or lead a customer to pay more for a brand.

There are a variety of ways to measure a brand's value, and one way is through conjoint analysis, a statistical tool which can help to determine the incremental price companies can charge for a product as a result of their brand and the added market share that companies can capture through their brand, says Reibstein. In marketing parlance, conjoint analysis focuses on the joint effects of multiple product attributes on product choice. It involves providing a sample of customers with choices that are systematically varied on a set of attributes. The customers' preferences or likelihood of buying reflect the weight they place on each attribute in order to make a choice. These weights are typically calculated using regression analysis.

Such analysis and concrete measurement of intangible asset values will not only help put marketing investment in perspective for CEOs and CFOs; it can also be used as a tool in customer relationship management, Reibstein notes. He points in particular to NASCAR, which has mastered the art of demonstrating to their sponsors the value of their sponsorships. NASCAR provides a comparison between the cost of brand name exposure that a sponsor gets and the cost of getting the same level of exposure through traditional media. It also provides information on purchasing probabilities of sponsors' products, as well as change in sales before and after sponsorships.

Working out the multi-year impact of intangible assets is not a call for increasing marketing budgets, adds Reibstein, but rather a way to bring out the true value of marketing expenditure. "The problem is not that investment in marketing is ineffective or has a poor rate of return," says Reibstein. "It is

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much more an issue of making sure that companies can capture the long-term value of marketing."

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