Chapter

4

THE MEASURE OF MARKETING

From Measurement to Improvement

"The most urgent problem facing the newly independent United States was how to pay for the war that won the country its freedom; America's debt was enormous. Its greatest asset was the land west of the Ohio River, but for this huge territory to be sold, it had first to be surveyed–that is, measured out and mapped. And before that could be done, a uniform set of measurements had to be chosen for the new republic out of the morass of roughly 100,000 different units that were in use in daily life."

Andro Linklater, *Measuring America*

In the early years of America's independence, land itself was an "intangible" that defied clear measurement. It wasn't until the new frontier was accurately surveyed and measured that the country's promise of dynamic prosperity could at last be fulfilled.

We face a similar challenge as we struggle to map out the intangible realm of customer value and measure marketing's impact on growth, profit, and shareholder wealth. Marketing, as we have said, is in a privileged position to identify key market trends and opportunities, to more deeply connect the enterprise to its customers. Marketing, therefore, must act to drive growth.

But marketing also must defend and validate its actions, and the measures of its performance must be clear and definable. Those measures and performance results, rather than allocation-based budgets, will guide the investment of corporate resources in marketing.

The development and application of rigorous new measurement initiatives is a critical step in an organization's move toward high performance marketing. You cannot manage that which is not measured. Disciplined marketing depends on measurement—both as a way of assessing the impact of marketing investments, and as a lever to drive continual performance improvement.

DEMANDS FOR ACCOUNTABILITY

We live in an ongoing era of accountability. Shareholder skepticism and the introduction of the Sarbanes-Oxley Act are rippling through the corporate world, forcing top executives and board members to demonstrate new levels of diligence and transparency in order to rebuild lost confidence.

Marketing, while traditionally one of the least measured functions of the enterprise, is a significant expense in many organizations and the implications of its actions are critical to corporate performance overall. Unsurprisingly, CEOs, CFOs, and board members, who are under more pressure to be accountable themselves, have cast a critical eye on the marketing organization and are demanding more and better reporting.

Marketing is responding to these demands. We see evidence that senior marketers are searching for new ways to measure marketing performance and build credibility within their organizations. One Forrester Consulting study involving 280 marketing executives from an array of industries found that their greatest challenge this year is "measuring marketing effectiveness or ROI."[1] Of the respondents, only 37 percent said their marketing organizations are perceived by those within the organization as being both strategic and capable of delivering measurable value. Another 32 percent said marketing is perceived as strategic, but incapable of measuring its impact, and 30 percent said that marketing is not perceived as strategic at all.

The measurement challenge was underscored by another study from the Chief Marketing Officer (CMO) Council, an association of technology marketers.[2] In a poll of 315 senior marketing executives, the CMO Council found that fewer than 20 percent of respondents have formal marketing performance measurement systems in place. In addition, almost 80 percent are dissatisfied with their ability to demonstrate their marketing programs' business impact and value. These results are especially significant given the fact that technology companies tend to be among the heaviest spenders in marketing. According to a Marketing Leadership Council (MLC) survey, high technology companies spent an average of more than 15 percent of revenues on marketing.[3] This is several times the percentage spent on marketing by companies in many other major industry verticals, including such marketing driven industries as consumer packaged-goods.

The CMO Council study, however, found that nearly 90 percent of respondents believe measuring marketing performance is a key priority for their organizations. "Growing boardroom pressures on marketing departments to justify and account for their spending, as well as more critical and demanding corporate performance environments, heightens this priority," according to the council. As opposed to asserting its own perspective, marketing has reacted to these demands by putting measurement, ROI, and other elements of "accountability" on the front of their agendas.

But measurement isn't just about diligent accounting. In fact, one of the major challenges in marketing measurement is determining what to measure. The range of options is vast, perplexing, and sometimes contradictory. Advertising can be designed to increase awareness, recognition, or recall, to improve consideration, or to drive traffic to a retail center or Web site. So which one matters most? Direct marketing effectiveness can be measured in terms of the response to a mailing or an e-mail campaign, but the quality of the responses may be more critical than the quantity. The actual revenue generated (which can be influenced by price levels as much as by response), can also be a relevant metric. Sometimes the cost of acquisition is the key measure while other times the potential lifetime value of the customers acquired may be more critical. So determining what to measure is a very important, but too often neglected, first step.

The functions of measurement go beyond explaining what has happened in the past; measurement also moves us forward toward appropriate actions and improvements. Useful measurement requires appropriate reporting on the allocation of marketing resources and their investment return, but it also requires that we take action—and intervene—when key objectives are not being met. Measurement should guide us as we invest incrementally in programs that do meet or exceed their targets.

Rather than one more mandate from the executive suite, marketers should see measurement as a critical lever to enhance performance and drive value in a continual way. Indeed, measurement is central to the success of marketers' careers and organizations. Rigorous and appropriate measurement—ultimately linked to financial measures—will earn marketing executives a place at the table with their peers in operations, manufacturing, finance, and sales as well as entry into the boardroom. Just as the Total Quality Management and Six Sigma movements have driven new standards of improvement on the supply side of business, we now have an opportunity to drive performance levels much higher on the demand side of business.

While the economy goes through cycles and the fashion for marketing measurement comes and goes, true leaders will recognize the necessity to build a "measurement competency" as part of a larger performance culture. That is why appropriate measures is one of the key dimensions of marketing performance.

MEASUREMENT MYOPIA

As they seek to improve the return on marketing activities, senior marketing executives ask a number of questions: What is working and what is not? Which marketing programs show promise? Who are our most profitable customers? Who are the least profitable? What is the profitability breakdown of our various channels? How are we aligning our limited resources with our greatest opportunities? Where should we invest? Unfortunately, most organizations do not have any practices, processes, or measurements in place to find and provide the answers to these questions. Without the insight required to intelligently assess investment options, marketing is vulnerable to both underinvestment and overinvestment—the value-eroding misallocation of resources.

Marketers have all sorts of metrics and statistics available to them, of course; but too often, the data is useless or irrelevant and disconnected from the larger objectives of the enterprise. Marketers tend to confuse measured data about specific campaigns, channels, media, events, and activities with a comprehensive analysis of marketing payoffs. Marketing tends to measure isolated silos of activity, but it fails to provide a wider and more rigorous perspective to guide marketing investment decisions. As a result, the most significant indicator of the size of one's annual marketing budget and the particulars of allocation is the previous year's budget. Rarely does a marketing organization rigorously reassess its investments without a precipitating crisis.

Meanwhile, the argument of whether marketing is primarily art or science has continued. When marketers were accused of being "hucksters" and "hidden persuaders" in the 1950s and 1960s, they fought back by emphasizing their grounding in measurement and science.[4] As a result, marketers became particularly proficient in bedazzling their clients with sophisticated measurement techniques and statistical analyses. Today, many of these techniques remain actively in use, especially in the consumer-packaged goods companies.

Complex technique, however, is no replacement for comprehensive perspective and insight. It's clear that, while we do have an array of sophisticated metrics, many companies still have no clear sense of whether their marketing dollars are being invested properly. Most companies do not even differentiate between necessary marketing expenditures that are a cost of doing business versus expenditures that are investments in the future with a longer term payoff.

Marketing expenses are often linked with particular elements of a media mix rather than to the customers we intend to grow. We have budgets for advertising, direct marketing, and supporting the sales force (budgets based on areas of activity as opposed to results and outcomes). Some marketing organizations, in fact, tend to be quite advanced in the measurement of certain activities and channels, such as advertising, direct marketing, or sales. However, marketing organizations generally do not have an integrated approach for measurement, reporting, and investment across operations. As a result, they work with a skewed picture of marketing performance.

Marketers say they are most capable of measuring direct mail and e-mail campaigns, Web site and Internet search engine presence, and telemarketing and contact management programs, according to the CMO Council's research.[5] However, they are least capable of measuring advertising, sales and marketing collateral, and branding. Relying on their "strengths," many marketers optimize the measurement of certain activities, rather than the measurement of enterprise-wide performance. It is not uncommon for companies to focus on the activities they can measure well, emphasizing the ones that can help them meet preset sales quotas, while cutting back on longer term investments in activities that can build brands and enhance shareholder value. This piecemeal accumulation of metrics fails to provide a comprehensive picture that can drive smart management decisions, and is akin to searching for one's keys where the light is best rather than where one might have dropped them. No marketing organization will reach its potential as a force for growth within the company using this approach.

Cathy Bessant, the Chief Marketing Officer of Bank of America, is alert to this danger. "We are very disciplined about our approach to measurement and disciplined processes, but we also want to avoid the tyranny of measurement," she told us.[6] "It is important to measure whatever you can, but it would be naïve and dangerous to focus investment on measurable activities and channels while neglecting those that may, in fact, be more effective but are not necessarily as measurable. Good business judgment, a grasp of the overall marketing portfolio, and an understanding of what you expect from different parts of the portfolio are extremely critical to maximizing overall business impact."

What CEOs Want: Linking Investment to Outcome

Yet another challenge for marketing leaders may be the absence of clear and tested linkage between the marketing performance metrics they employ and the outcomes they seek. This pattern has undermined the value and credibility of many marketing measurement efforts. The sheer act of measuring may not produce value. In fact, poor or careless measurement can prove an enormous misuse of resources.

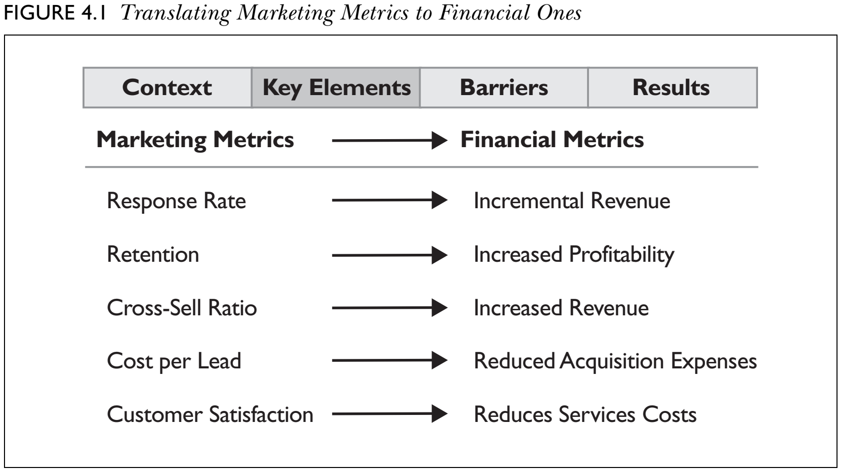
What the top executives within companies seek is a linkage between investments and outcomes. Financial measures such as revenue, profit, and shareholder value, frame our understanding of overall corporate health, even though they fail to show us the underlying health of a business or support management decision making. Financial metrics offer a retrospective view of results; they do not indicate what actions we must take to drive results. However, these are the results most often reported to the financial marketplace and the investors who have the last word on shareholder value.

Marketing is well positioned to bridge this measurement gap. Measures of customer loyalty, attitude, or behavior can be linked to customer profitability and lifetime value, which, in turn, can be linked to financial measures. Marketing measurement is a constant process that depends on multiple metrics, rather than a single number or snapshot of organizational health. Thoughtful marketing measurement reflects the current state of the organization, even as it influences what the company can do to change its future state.

Bill Moult, founding partner of Sequent Partners and a former president of the Marketing Science Institute, says marketing often produces lists of metrics that are not considered relevant by the CEO and CFO.[7] Such metrics don't work as credible measurements. Marketers, according to Moult, must take the steps necessary to link marketing and financial measurements. "It is critical to demonstrate the underlying structure or relationship between them," Moult adds.

As Figure 4.1 demonstrates, there are multiple ways in which classic marketing metrics can be translated into financial metrics. Through such endeavors, marketing can raise its credibility in the executive suite.

FIGURE 4.1 *Translating Marketing Metrics to Financial Ones*



Of course, cultural resistance to measurement and analytic thinking can be problematic, too. Many executives continue to rely on intuition, experience, and conventional wisdom to guide their decisions. One 2002 study by executive search firm Christian & Timbers found that fully 45 percent of corporate executives rely more on instincts than facts and figures in running their enterprises.[8]

While instinct and intuition may be key attributes of leadership, they may not provide the best foundations for the increasingly complex decisions we as marketers are forced to make in an era of global, real-time commerce.

Positioning Measurement at the Core

As today's leading marketers now see it, measurement must be central, not peripheral, to the development and management of a performance-driven marketing organization. Measurement becomes part of one's role and set of responsibilities. It is an essential element of the marketing and management skill set.

This organizational paradigm goes beyond the current array of techniques that are now on offer, although most organizations would do well to adopt some of those techniques as a start toward more effective marketing. In fact, techniques are themselves context-dependent. Some companies will prefer top-down measurements; others bottom-up. Some are concerned about brand equity; others focus on customer equity. Some prefer ROI metrics; others prefer free cash flows. Some theorists believe marketers should take the reins in the measurement arena; still others believe the reins should be turned over to finance and accounting.

These decisions certainly are important, but the current challenge facing marketing is less about technique than mindset, organizational discipline, and culture. In fact, marketing organizations must be prepared to introduce, test, and adapt improvements on a constant basis. Marketers must have the capacity and will to make the necessary linkages between actions and outcomes. Many leading edge companies have created a group within the marketing department that is responsible for performance measurement. This group often functions independently of the managers responsible for developing or executing marketing programs and reports directly to the Chief Marketing Officer or Vice President of Marketing, sometimes with dotted-line accountability to the CFO.

Marketers must lead the way toward an era of rigor and discipline. Facts, as they say, are our friends. Whereas some marketing theorists believe marketing can elevate its place in the organization by embracing transformative initiatives that hold a valued place on the CEO's agenda, the real deliverance for marketing lies in its insight, its command of real-world activities and outcomes, and its special perspective on the customer. Marketing is in a uniquely powerful position to drive innovation and improvement where it is most required, on the demand-side of business. But it can't accomplish this objective without facts, evidence, and actionable insight.

Many companies are already seeing the benefits of positioning measurement at the core of their marketing organization. Through measurement and analysis, a small life insurance company found that that it is more effective to focus on marketing $50,000 policies than $200,000 ones, even though the latter might appear to be more valuable. The company discovered that conversion and retention rates linked to the smaller policy holders are far greater, eclipsing the face value of the policy as a key variable of profitable growth. “We have to consider the revenue stream in relation to the conversion rate,” explains the president of the company, noting that the company actively measures cross-sell, up-sell, and other investments to clarify where its marketing investments deliver the best outcome.

The path to world-class marketing excellence lies in a rigorous commitment to measurement, and the performance improvements that measurement makes possible. Indeed, measurement is a critical element in one’s efforts to identify the gaps that hinder the execution and enhancement of growth-oriented business strategies, and disciplined marketing is impossible without a clear understanding of the facts on the ground.

LINKING ACTIONS AND OUTCOMES

Although they are critically important to forming a disciplined approach to marketing, “facts” can be difficult to establish and defend. Establishing strong links between actions and outcomes is often quite challenging. Even the linkages that once seemed clear can become less so over time.

Frederick Reichheld, a director emeritus at Bain & Co. and a longtime champion of customer and employee loyalty initiatives, has raised many questions over the years about the validity of customer satisfaction as a meaningful measure of future behavior. Surprisingly, he has even begun to raise questions about customer loyalty as a key measure of progress and success. While he hasn't completely disavowed his past work, Reichheld admits that his theories have never caught on in the real world of business.

As Reichheld now sees it, "retention rates have not progressed over the last decade. Where the rubber meets the road, customers are not demonstrating loyalty.... No one defined what loyalty was. There was no measurement, no link to profitability or growth. There was a lack of definition. What is loyalty? If what you mean is putting up with lousy value or service, do you want stupid customers?"[9]

Now, he is interested in customers who are willing to recommend a company's products to a friend or a colleague. Reichheld believes that, in addition to measuring customer profitability, companies should also be identifying the "promoters" and "detractors" among their customers, with the obvious objective of increasing the number of promoters. "The median 'net promoter score' is just above 10 percent," says Reichheld in *Direct Magazine*.[10] "Most companies have 10 percent more promoters than detractors. But the best companies have 80 percent more. The net of promoters minus detractors doesn't show up in profit and loss statements, but detractors destroy your future and make your employees feel lousy."

A great example of a company that relies on customers for promotion is Amica Insurance. Amica, the oldest mutual automobile insurance company in the United States, actually took this notion to an extreme. It would not accept a new customer unless that customer was "referred" by an existing customer in good standing, although the company has since modified this policy. It still does not advertise or employ agents in an industry where most business is driven by aggressive agents. It relies on word of mouth referrals from customers. At a time when most companies measure customer attrition on an annual basis, more than one-third of Amica's customers have been with the company for more than 20 years. When I have shared the Amica story with audiences, I will often have someone in the audience raise their hand and talk about generational loyalty (saying, for example, "My grandfather and my mother were Amica customers and now I am one, too."). The

CFO of one or our client companies is a passionate advocate for Amica, in addition to being a lifelong customer, due to the outstanding service he received when his home was destroyed by a hurricane.

One enterprise that is rigorously focused on optimizing marketing returns is Cleveland-based KeyBank, which manages assets in excess of $85 billion. It has been investing in "marketing performance optimization," which enable it to match marketing actions and outcomes. KeyBank has developed sophisticated models for forecasting and scenario planning across media, channels, and geographies. "You can see what happens when you move dollars around," says Trish Mathe, Senior Vice President and Director of Database Marketing.[11] Mathe says that KeyBank has cultivated a "culture of accountability." In this case, accountability is made visible to all through an array of corporate and departmental scorecards as well as marketing "snapshots" that capture key indicators of performance. "It [accountability] has closed the gaps in our reporting on marketing campaigns and helps us plan the media mix appropriately." Mathe noted. "It forces a kind of scientific rigor and drives more intelligent conversations."

A COMPREHENSIVE, INTEGRATED VIEW

What many marketing executives most need is a comprehensive decision framework to help assess various marketing initiative options in a diligent and rigorous way. This framework can help guide judicious investments, enabling marketers to compare and assess outcomes, and then reinvest for maximum returns. Such visibility will enable marketers to defend marketing budgets and build corporate confidence. If marketing returns are clear and impressive, they will invite even greater levels of investment. Measurement enables us to test our assumptions, discover what is working and what is not, and continually refine our performance.

The following matrix outlines a very simple framework that can serve as a starting point for such an assessment. The first column of this matrix lists marketing elements used by many companies; the rows extending from each of these elements show measurements used to assess the marketing element. As you move across the columns, the measures go from the obvious to the not so obvious, from marketing measures to financial measures, from response to profitability.

Sponsorship	Awareness	Recognition	Influence	Purchase
Direct Mail	Response rate	Buy rate	Revenues, RFM	Profitability, Lifetime Value
Advertising	Awareness	Consideration	Intent	Purchase/ Repeat
E-mail	Open	Click-through	Purchase	Value
Promotion	Response rate	Incremental Volume	Cannibalization	Incremental Profitability

Since companies are interested in ROI and financial measures, why do they not immediately go to the extreme right and focus on those measures? The problem is that as you move from left to right on the chart, the measures are more complex and may require fairly sophisticated analytics. Many organizations do not have these skills and have determined, sometimes quite legitimately, that it is not worth their while to invest in them.

A senior executive at a major direct marketing company told us precisely that. His company considers Recency, Frequency, and Monetary (RFM) metrics, all which have been heavily used in the direct marketing industry, to be effective measures of value, and doesn't see the economic justification for pursuing still more sophisticated and precise measures such as Life Time Value (LTV) of customers.

"RFM measures are our proxy for lifetime value of a customer," he explained. "We realize that there are many nuances that we miss by using RFM, such as the price sensitivity of the customer and the potential future value of different customers. However, the rush to get stuff out the door and the daily operational pressures make it very difficult for us to invest a great deal in testing and R&D into these issues. If we are able to meet our numbers, the pressure to constantly improve how we do things is not felt as heavily."

RFM is a standard measure among most direct marketers and is very good for generating incremental sales through existing customers and others like them. However, it is somewhat akin to driving with a focus on the rear-view mirror. Understanding potential future lifetime value can be valuable in unearthing new and emerging segments and developing new products. It takes effort and investment, but the payoff can be significant.

Let me illustrate this point with another example, this time from one of our previous clients, a publishing company. This company owned a number of major magazine titles and spent a fair amount on direct marketing, mainly on renewal mailings, an initiative with which we are all familiar. The company spent a minor amount of money on cross promotion across magazine titles. It had a small analytical staff, including three statisticians who were very competent statistical modelers, but who did not really understand financial and economic models. Their focus was on the first level measures, response rates. They did test different prices for different mailings, but not to measure price elasticity, per se; instead, they measured response rates. The general manager, on the other hand, was not concerned about response rates to individual campaigns as much as the overall renewal rate and the total paid subscription level, since advertising rates were tied to this metric.

However, an analysis of subscriber LTV led to the conclusion that, for some of the magazines, subscribers who were first solicited with very low introductory rates often did not renew. Therefore, these subscribers did not really add in any significant way to the magazine's ongoing rate base, the paid circulation (what advertisers base their payments on). The incremental advertising revenue gained by having these subscribers in the customer base was not enough to justify the cost of solicitation at the price point at which they were willing to renew.

As these examples illustrate, the very scale and complexity, risk, and uncertainty of contemporary marketing often makes performance measurement much more critical than it might have been in the past. Under the circumstances, marketing investment has risen to an entirely new level of difficulty. As demands for greater performance and accountability increase, marketing leaders are charged with identifying the key drivers of growth and performance improvement. They are expected to be able to drill down into current actions and activities, and vividly demonstrate the impact of their investments.

Laying these options out within a single portfolio provides "the comprehensive perspective necessary to invest with discipline," says the senior vice president at a major financial services company.

Clearly, this level of clarity and discipline raises the credibility of marketing within the enterprise. The CMO council study found that companies that have formal performance measurement systems "consistently achieved a higher level of CEO confidence in the marketing function."[12]

THE PRINCIPLES OF A MEASUREMENT-DRIVEN PERFORMANCE CULTURE

In order to establish a comprehensive and integrated marketing perspective, marketing organizations must have the discipline to measure in a rigorous fashion. These measurements lay the foundations for performance improvement.

The leading marketers recognize that there are a few essential objectives they must set and meet if they are to produce valid measures on an ongoing basis and successfully rely on them to drive action. These three principles must guide a measurement-driven performance culture:

1. Measurement must be relevant
2. Measurement must be visible
3. Measurement must drive improvement

Let's look at each of these principles in more detail.

Measurement Must Be Relevant

The most highly sought-after financial outcomes may include increased shareholder value, revenue, or profit growth. Marketing must target more immediate performance objectives, however, in order to deliver on such financial targets. Therefore, it must make causal linkages between key measures such as customer satisfaction, cross-selling, or campaign response rates and the financial results it seeks to produce.

These links are not as obvious as one might think. In recent years, critics have raised questions about the implications of customer satisfaction, for instance, on overall corporate success. Even marketing campaigns that are apparently successful may not be truly successful if outcomes are misaligned with objectives. (Consider a no-interest financing campaign for a new car that generates tremendous response, but merely eliminates all margin on the purchase. U.S. carmakers are very familiar with that particular impact of their marketing.)

Let us take for example another previous client, a banking institution. This bank had a major deposit generation campaign in which it paid above-market rates for CDs. The bank raised deposits, but ended up cannibalizing money from many of its existing accounts at a much higher cost. As a result, the campaign cost the bank more than $15 million in net income. The bank's increased deposits were directly linked to a decrease in its income. This outcome was not apparent, however, until we were able to analyze the entire customer portfolio of deposits and were able to see the flows from mutual funds and checking accounts to these hot CDs. Prior to this analysis, the executive who was leading the deposit generation campaign looked like a hero for having grown deposits in his geographic region much faster than his counterparts elsewhere. After the analysis, he disclaimed all responsibility for the decision to offer above-market interest rates. [13] To be successful in terms of measurement, marketers must rigorously and diligently test their assumptions. Until a clear linkage between actions and outcomes is established, the relevance of favored performance metrics is merely a hypothesis. Sometimes, marketers merely need to dive deeper to determine the true implications of an action. During the refinance boom of the past few years we have often seen instances of financial institutions advertising mortgage rates and soliciting business aggressively. We found that the ability of their back offices to actually fulfill and close on those loans could not match the demand that was generated, leaving them with irate prospects who failed to become customers.

As linkages are tested and established, it becomes easier to weight the relative importance of one metric versus another, and to decide which marketing activities are worthy of investment within a portfolio of marketing options.

Measurement Must Be Visible

Essential to the continuing success of today's marketing organization is its ability to determine and clearly communicate the impact of its actions. While it is clear that most companies have important benefits to gain from smart marketing measurement, it is hardly certain what the most relevant metrics of marketing performance might be from one company to another.

The level of resources that must be devoted to the measurement task will, of course, vary too. It will depend on industry dynamics, the size of marketing budgets overall, and each organization's existing proficiency in measurement. Marketers must put their best effort into measuring the outcomes of their current activities and investments. This is the critical foundation on which marketing improvement, and, perhaps innovation will emerge. Marketers must measure to determine where they should invest, and where performance improvements are necessary.

Furthermore, marketers must measure and report outcomes to meet the executive suite's growing demands for accountability. Indeed, they must communicate performance outcomes to reestablish credibility with corporate decision makers. Deeper credibility lays the foundation for larger and certainly more effective marketing investments. Performance-driven marketers have nothing to fear from new measurement reporting processes. We have found that these more relevant and effective measures often already exist within marketing organizations, but are not widely shared inside and outside marketing. It is a problem that must be addressed to achieve a successful outcome.

Measurement Must Drive Improvement

As we stated earlier, measurement is not simply about accountability. True, measures should enable us to better determine how investments have played out and assess whether we are addressing our objectives. More importantly, however, marketing measurements should drive new improvements and performance gains. Such measures can help us generate growth in customer value and take the actions necessary to ensure that the marketing organization is performing at peak levels.

Measures represent a powerful lever for organizations that are struggling to drive performance gains. They have the potential to depersonalize and depoliticize change. Objective measurements provide a touchstone to guide actions. Actions can be taken not as a response to the hunches or whims of powerful people, but because the measurement system is indicating that a change must be taken.

On the foundation of measurement, marketing leaders can take action to ensure they are maximizing the return on their marketing investments. They may discover that they need to shift resources from customer acquisition to customer development. They may find they need greater skills and expertise in terms of customer segment analysis and management. They may learn that the marketing organization is not aligned with a key channel such as the contact center.

Such discoveries occur through the application of measurement. Acting upon these discoveries is the next step. When a company acts on the results of its measurements, it demonstrates to the rest of the organization that measures matter. By contrast, marketers that fail to act on the measures that have been implemented tend to create an air of cynicism about measurement, and eventually, the measurement efforts either become meaningless or stop altogether.

The measurement-driven performance culture is reinforced by many other elements. Organizations that want to truly promote this culture must link rewards, compensations, and promotions to measurable results. Communicating the value of measurement and discussing the implications of acting in a measurable, disciplined way also are essential steps in carrying out this cultural shift. Finally, these organizations must provide the training and skill development necessary to measure activity. For many people, measurable marketing will come with an array of unfamiliar requirements and demands. They must not only have the will and motivation to meet these demands—they must also have the necessary skills and expertise.

A financial services company we counseled was very aggressive with its cross-sell program. All of the front-line staff in the retail branches and the call centers were heavily incented to sell additional products to customers. Analysis of customer behavior showed that many customers did not use the additional products and services that were thrust on them by aggressive salespeople. As a result, the company actually lost money on these products, since there were very low balances on these accounts. By adding measures of retention and compensating sales associates for growing the overall balances in the accounts, the company was able to change the behavior of it associates, reduce retention, and increase profitability without proliferating unnecessary growth of products among its customers.

In the 1990s, Procter & Gamble took the bold step of cutting its trade promotion budget drastically (a major part of its overall marketing budget) and moving to everyday low pricing. This move was based on a detailed analysis of scanner data from supermarkets around the country that showed that constant price promotions "trained" customers to buy items on sale and eroded the power of its leading brands to command premium pricing. It was also extremely inefficient because sales volumes shifted dramatically in response to temporary price changes, and led to costly inventory, logistics, and manufacturing variances.

Additionally, the cost of tracking and administering these complex trade promotion programs was considerable for both the manufacturers and the retailers. I know of one midsize supermarket chain in the Northeastern United States that employed more than 150 people just to keep track of rebates and promotions from manufacturers. Subsequent to P&G's move away from promotions, many other companies followed suit, and the result is considerable savings to consumer packaged-goods companies and retailers. This major change would not have been possible without P&G's ability to measure and analyze supermarket scanner data across varying markets over time.

Of course, the development of a measurement competency or dimension is never complete. Markets change. Disruptive innovations are introduced. Customers make new demands. An adaptive, robust marketing organization is one that continually challenges, tests, and refines its metrics. It ensures the linkages between marketing measures and financial measures are clear and defensible. And it acts on what it learns to continually improve marketing operations and outcomes.

CLOSING THE GAP: MARKETING MEASUREMENT SUCCESS FACTORS

The linkage of measurement to action, more than any other factor, drives organizational change and improvement. When the impact of measurement is clear and discernable, the value and importance of measurement can be internalized. To make measurement an essential part of the marketing performance culture, marketers need to have a recognized measurement process to guide activity and continual improvement.

While measurements may be quite sophisticated in various parts of the marketing organization or the front office, the objective in developing this process is to establish a discipline of measurement that can be followed by marketing overall. Achieving this objective requires us to develop a cross-functional, boundary-spanning approach to marketing measurement that can deepen understanding of performance goals and strengthen our ability to meet them

On the following pages, we offer some key process steps that marketing organizations can use to guide their own measurement efforts.

Building a Performance Measurement Model

While this objective is easier set than met, the establishment of a comprehensive measurement framework is central to strong marketing performance. The framework should attempt to encompass all relevant inputs and outputs, actions, and outcomes associated with the marketing organization to be truly comprehensive. It is not enough to simply cobble together a report based on the various silos of measured activity. This undermines the opportunity, and necessity, to measure marketing from an integrated perspective and make relevant comparisons.

While the development of such a framework may seem an intimidating endeavor, it is of course possible, and perhaps preferable, to build it in incremental stages. The model will evolve and become more sophisticated over time, through trial and error, experiment and learning. It need not be world-class in its early iterations. The key to success with the model is to embark on the initiative. Once the framework has been launched, marketing can build momentum and refine the organization's perspectives. In fact, we recognize that marketing will first test and deploy the model internally. While input and comment should be sought throughout the organization, marketing should validate and refine its own reporting framework before inviting others within the organization to use it.

Acquiring Measurement Data

Marketing measurement initiatives cannot and will not survive unless the discipline is in place to gather the relevant data necessary to measure. Many measurement efforts in many organizations over the years have foundered on the sheer difficulty and expense of gathering relevant data. Marketing must ensure that the measurements sought can, in fact, justify the expense of acquiring the data. For example, supermarket scanner data that P&G used to make their everyday low price decision was purchased from a syndicated scanner data company such as IRI or Nielsen, but the analyses and relevant measures that led to the decision had to be developed within the company.

Collecting customer data can be a particularly difficult and expensive challenge for companies that sell through intermediaries, such as retailers or distributors. However, the formation of a customer panel or even a user community can provide a platform for data collection that circumvents the channels. The use of product registration cards by appliance makers and software and hardware marketers is an example of this type of data-gathering, although few of these companies truly leverage this information. Yet another client, an office supply company that sold through intermediaries and retailers, built a large panel of administrative assistants who were able to provide them with market and competitive intelligence that was not otherwise available, giving them a competitive edge. They did so by providing special services to this segment of their end customers who no one else was paying attention to–a very innovative approach to data collection.

Once it is clear that the measurements can add relevant and justifiable value, the marketing organizations must devote necessary resources in the form of time, money, and talent, to acquiring the key data. The organization also must assign roles and responsibilities for carrying out this effort. In many cases, the relevant information may exist in various departments and systems. Finding and aggregating this information is a critical element of this endeavor's success. If it is not consistently gathered, the value of the measures and the initiative overall will erode.

Analyzing Data and Generating Key Indicators

It's critical to recognize that a model is just that: a representation of reality. Its assumptions are merely assumptions until they can be tested and causal links between actions and outcomes can be more firmly established. Even then, measures that proved relevant at one point can prove less so over time. Performance measurement frameworks, however, provide a foundation for testing assumptions. When links have been established, the marketing organization can present its measurements with an appropriate degree of confidence.

Different metrics and indicators will prove to be relevant in different contexts. Andrew Abela, the former managing director of the Marketing Leadership Council, contends that a small number of "leading indicators" might be particularly valuable in terms of smartly investing marketing resources.[14] (For instance, a luxury car company might generate a metric based on a survey question such as "Do you intend to purchase a car in the next 12 months?") Dipak Jain, Dean of the Kellogg

Graduate School of Business at Northwestern University, told us that companies should be actively assessing and measuring how their customers derive value from their products and services. "Once I have those metrics then I also know how to capture the value we have created by pricing the product appropriately," he added.[15]

As linkages between actions and outcomes are established, marketing must generate the key performance indicators that will appear within their marketing scorecard, dashboard, or measurement system. These are the measures that will matter going forward. One can expect significant discussion and debate over the establishment (and weighting) of the actual measures. However, once they are chosen, they can be perpetually updated based on new measurement data. Attention turns to trendlines and performance.

Reporting Performance

The framework promises to provide a strong platform both for performance reporting and management decision making. However, marketers must have a system for communicating the findings from their performance initiative. While all variety of high-tech and low-tech approaches have been adopted for other types of performance reporting, marketing will have to choose the medium and format that is most valuable for this endeavor. Currently, there is a great deal of development going into the actual presentation of performance scorecards and analysis. Tying into existing systems, such as a balanced scorecard, can help make this step easier.

While many reporting options now exist, the critical factor is reporting itself. Once the marketing organization begins to report its performance results, marketing changes the relationship between itself and the rest of the organization. Reporting opens up new conversations and opportunities for collaboration, within marketing and beyond it. Also, while senior management increasingly demands that reporting be done on the basis of accountability, it's clear that such visibility can also strengthen marketing's credibility with senior decision makers.

Leveraging Measurements to Drive Decisions

The value of measurement is inseparable from its impact on management decision making. If measurements are disregarded, then their importance will diminish. The whole objective of measuring marketing performance in the first place is to strengthen management decisions and drive greater investment outcomes. Of course, some measures or drivers will be weighted more highly than others. Predictably, those metrics will have a greater influence on capital and resource allocations.

Performance indicators should prove to be a powerful guide for investment. Consider Frederick Reichheld's notion of "promoters" and "detractors."[16] If a strong linkage has been made between the number of customers willing to recommend one's product and the profitability of the firm, then clearly companies must do more to ensure they have a strong base of promoters. Those are the kinds of actions that must be taken and decisions that must be made if measurement efforts are to have a lasting impact.

Enabling Learning and Performance Improvement

Based on the findings that are generated through performance measurement, marketing is in a powerful position to drive new performance gains. Measurement becomes an indispensable tool for demonstrating in an objective, dispassionate way, the gap between actions taken and outcomes achieved. It provides a rallying point and communications vehicle for driving new levels of performance.

Without measurement, management actions are a matter of political will and executive intuition. In measurement cultures, action and improvement become far more collaborative, and hopefully, clear. Measurement platforms lay the groundwork for perpetual learning and performance improvement.

Just as the surveying of America's uncharted Western territories set the stage for a nation's extraordinary growth, today's efforts in measuring the intangibles of marketing and customer value will lead to tremendous new fortunes. At this transitional moment, marketing leaders have much to gain. If we are willing to rethink the way we measure and invest in marketing, we can differentiate our companies, generate new levels of profitability, and establish enduring relationships with our most valued customers.

Measuring Marketing: One Perspective

At Quaero, we developed an integrated measurement framework–one that allows for retrospective analysis of past efforts and results, and prospective analysis to identify opportunities for future refinements and investments. The framework is the tool we employ to map out marketing investments and returns, plotting them onto a matrix to visualize various causal linkages and relationships.

Charting the Customer Engagement Cycle

This framework maps a set of marketing measurement dimensions to a multistage process we call the Customer Engagement Cycle. This cycle recognizes the development of customers (including prospective customers) within a segment along five stages of engagement: awareness; consideration; inquiry; purchase, and expansion. These are the broad stages through which a typical customer passes as a relationship is cultivated. These stages are described within the Marketing Performance Framework: Customer Engagement Cycle chart shown in Figure 4.2.

FIGURE 4.2 *Marketing Performance Framework: Customer Engagement Cycle*

	Awareness	Consideration	Inquiry	Purchase	Expansion
Business Objective	Breakthrough and recognition	Relevance and inclusion in decision set	Differentiate and inform through two-way sharing	Move to desired action; shared commitment	Ongoing engagement and development
Event Description	Presentation of messages and/or an initiation of contact designed to generate customer awareness of product, brand, or service	Presentation of messages and/or an initiation of contact designed to encourage prospective buyer to demonstrate interest in product, brand, or service	Exchange of information in a two-way dialogue or targeted information request	Actions designed to encourage commitment–purchase, loyalty, etc.,—leading to an exchange of value	Actions designed to encourage additional exchange of value and deepening commitment

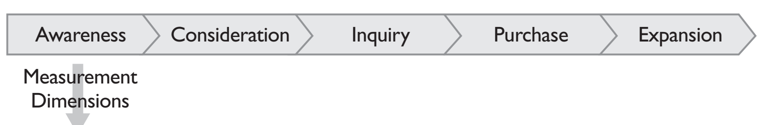
By recognizing these stages, we make it clear that marketing actions, or investments, influence customers in different ways at different points of relationship development. Mass media advertising, for instance, might be more successful for reaching out to customers in the awareness stage, while investments in direct selling might be more appropriate as customers enter the purchase or expansion stages. The key here is to ensure that the right actions are taken at the right stages and that limited resources are smartly deployed.

While the Customer Engagement Cycle enables us to see the different stages of customer development, marketing measurement dimensions actually track the actions, outcomes, and implications of our investments relative to the stages of the cycle. Each of these dimensions involves a set of metrics that have specific applications, as illustrated in Figure 4.3.

Here are some of the key marketing measurement dimensions our clients are tracking.

- *Actions and activity.* This set of metrics is designed to identify and quantify the particular actions and activities that have been taken to generate marketing results at a given stage of the Customer Engagement Cycle. As such, this measurement dimension is a

FIGURE 4.3 *Marketing Performance Framework: Measurement Dimensions*



Action and Activity	Measures the resources, programs, and activities devoted to achieving marketing objectives. These indicators look primarily at programs, inputs, and investments.
Marketing Impact	Measures the results of marketing activities within each stage of the customer engagement cycle (response rates/conversion rates, closed sales, click-throughs, impressions, etc.).
Financial Impact	Measures the financial aspects of the marketing programs, including cost and return on investment at each stage of the customer engagement cycle. These measures link the results of marketing activities to financial outcomes.
Customer Impact	Measures the impact of marketing activities on customer segments (loyalty, wallet share satisfaction, profitability, etc.) at each stage of the engagement cycle.
Time and Migration	Measures the time required to move customers through the engagement cycle and provides indicators of migration difficulty.

gauge of inputs and investments. Key indicators, for example, may include an inventory of campaigns, media buys, or sales initiatives. Tracking this dimension helps our clients recognize the marketing resources that have been devoted to driving outcomes, which can help them determine whether resource allocation is aligned with stated objectives. Through the exercise of merely mapping out marketing activities, one of our financial services clients quickly realized that its strategy of cross-selling and up-selling existing customers was relatively unsupported. It discovered that the vast majority of its actions and activities were occurring during the awareness stage of the engagement cycle as opposed to the expansion stage. Conversely, we have seen clients realize that they have underfunded customer acquisition initiatives by investing most of their resources in the later stages of the cycle.

- *Marketing impact.* This set of metrics looks at outcomes, or effectiveness, from a marketing perspective. It measures operational results such as response rates, conversion rates, closed sales, even click-throughs and Web site impressions. This information is useful for performing consistent comparisons based on which marketing vehicles or programs are effective in moving customers to the next stage (within a stage of the cycle). The inclusion of market research metrics such as awareness, share of market, satisfaction, etc., can provide an insightful backdrop when viewing programs or campaign-based metrics. Looking at these indicators across stages of the Engagement Cycle can also highlight areas for reallocation of marketing investment. Marketing impact metrics enable us to isolate specific opportunities for improvement and to determine what actions might be taken to realize our goal.
- *Financial impact.* This set of metrics is designed to translate operational marketing metrics into financial outcomes. Costs per activity, such as cost per impression, cost per call, cost per customer, and so on, are building blocks for generating (ROI calculations at each stage of the cycle. Marketers can view sales attributions through this metric, and then map out the impact of their activities on actual profit-by-customer segment. They can use the data gathered through this measurement dimension to assess past results and make future forecasts. Organizations are therefore able to treat marketing decisions as investments and

use the Engagement Cycle as a means of pinpointing where and how they will manage their marketing activity portfolio. Of course, financial performance and impact metrics speak the language of the executive suite and provide the types of measures that CEOs and CFOs will expect to receive in future reports on marketing performance.

- *Customer impact.* This set of measures examines the implications of our actions in terms of the customer relationship. In tracking this measurement dimension, we might look at specific metrics such as share of wallet, customer satisfaction, customer loyalty, or customer profitability. The key is to gain a greater understanding of the impact marketing's activities are having on customer value development. For example, a senior marketing executive might consider how certain marketing programs affected share-of-wallet metrics over the time the programs were being implemented. One of our financial services clients looks at patterns of customer development, probable customer migration paths, and paths of greatest value. Marketers can use the metrics within this dimension to hypothesize and investigate causal links between marketing actions and marketing performance, and to make appropriate investments, adjustments, and reallocations.
- *Time and migration.* This set of metrics tracks the amount of time required to move from one stage of the Engagement Cycle to the next. Moreover, it assesses the degree of difficulty associated with enabling that transition. Finally, it measures the cumulative costs of actions, activities, and programs in order to evaluate programs and investments. While there may be programs that have good individual ROI or performance results, the cumulative cost of these activities in moving a customer to a new stage in the engagement cycle may be higher than other programs. The cost of migration is important, but so is the time necessary to accomplish the task. Opportunities must be quickly seized or they will be lost. Considering the rapid rate of change in today's hypercompetitive markets, it is critical to recognize "time" as a component in the overall assessment of marketing performance.

Applying the Marketing Performance Framework

While the framework itself provides context for assessing different decisions, the actual plotting of marketing activities on the map, the measurement of results, and the recognition of timing in the engagement cycle adds texture to our understanding of marketing investment returns.

By separating our actions and outcomes, we gain a comprehensive picture of marketing performance. Customer segment managers can see marketing results portrayed segment by segment and stage by stage. Similarly, program managers can see campaign and program results lined up in relation to segments and customer engagement stages. Such insights can help them refine and improve their spheres of activity.

Chief marketing officers, by contrast, gain the integrated view they need to drive strategy. Not only are they able to disaggregate perspectives by segment and stage, they can gather the results together and see them in aggregated form. They also can assess changes in broad measures such as awareness, customer satisfaction, share of customer, and others that are not comparable within a single period, but can be understood as trends over time.

One of our clients recently transformed its marketing organization through the development and application of this framework. Indeed, this Fortune 100 financial services firm has passionately embraced the opportunity to improve marketing measurement and effectiveness. The marketing organization currently is developing a host of new measures, actively integrating previously unused sources of data, implementing new processes for information capture, and data sharing. At the same time, the company is addressing the organizational and cultural challenges associated with marketing measurement.

Under the leadership of the chief marketing executive, the marketing organization has turned measurement into a critical priority and driving force. The marketing organization recognizes that the implementation of the framework is a continuing journey—one that will change the way it makes decisions and analyzes investments and outcomes. However, the measurement initiative already is having a dramatic effect with regard to how the marketing group thinks, operates, and improves. “Marketing is becoming a measurement-driven culture,” said the executive leading the charge. "And we are tying that into an overall learning agenda for the business."

In the past, the marketing organization would have been a customary beneficiary of the corporate budgeting and allocation process. Now, marketing is becoming a key driver of strategic decisions. Through its focus on measurement and accountability, marketing is earning credibility at the most senior levels of the organization. The framework enables the CMO to demonstrate to other corporate decision makers how marketing investments are supporting key business initiatives, which translates to sales, profit, and cash flow indicators. It allows marketing to make the business case for required resources on a clear and stable foundation, but it also enables the organization to measure and validate the impact of previous investments.

Marketing Measurement: Three Schools of Thought

As we see it, marketing measurement has fragmented into three schools of thought: *the ROI school*; *the Brand Equity school*; and *the Customer Equity school*. While these perspectives are not necessarily incompatible or wholly separate, they tend to emphasize different points and pursue different goals:

- *The ROI School:* ROI is widely used, and just as broadly defined. Research suggests that marketers favorably apply the language of ROI to everything from improving incremental sales to enhancing brand perceptions to growth in market share. Guy Powell, author of *Return on Marketing Investment* and one of the leading adherents of this school, defines return on marketing investment (ROMI) as "the revenue (or margin) generated by a marketing program divided by the cost of that program at a given risk level."[17] ROI is the simple approach that reflects the language of project and program justification that is common in organizations. James Lenskold, president of the Lenskold Group and author of *Marketing ROI: The Path to Campaign, Customer, and Corporate Profitability,* concludes ROI is "the ultimate measure for guiding marketing investments, because every marketing decision affects a company's ability to generate profitable sales."[18]

- *The Brand Equity school:* This school focuses on measures of brand equity, or brands, as assets. The Brand Equity perspective seems to be heavily influenced by consumer packaged-goods industry and other sectors, where value must be inferred from the attitudes and actions of vast consumer bases. Connections to the consumer tend to be indirect, mediated by retailers and resellers. Brand measurement champions are continually challenged to show how variables such as consumer attitudes and behaviors, financial investments, and environmental factors contribute to or detract from brand health. Linkages between the various management domains and measurement silos must be established if companies are to understand brand value over time, contend Bill Moult and Jim Spaeth of Sequent Partners.[19] Companies such as Interbrand and Copernicus Marketing have developed approaches to measuring brand equity. Tim Ambler, author of *Marketing and the Bottom Line: The Marketing Metrics to Pump Up Cash Flow*, encourages companies to look at marketing as a generator of brand equity that rises or falls over time. "Marketing is not a once-off capital sum, but a continuous stream of expenditures which the company makes every year," he says.[20]
- *The Customer Equity School:* This school has largely grown up in sectors such as financial services and telecommunications, where databases of specific segments and even individual customers have become a key asset. Robert C. Blattberg, coauthor of *Customer Equity: Building and Managing Relationships as Valuable Assets*, and Roland Rust, coauthor of *Driving Customer Equity: How Customer Lifetime Value Is Reshaping Corporate Strategy*, are among the leading thinkers in this field of inquiry.[21] They believe that customer insight will prove a powerful force in the evolution of business in the coming years. "[C]ompanies that understand the asset value of each customer, and that tailor their marketing efforts (and their costs) to acquire and sustain the highest-value assets, will trump less-focused mass marketers," state Robert C. Blattberg, Gary Getz, and Jacquelyn S. Thomas in their book.[22] That view is championed by Don Peppers and Martha Rogers, the authors of *The One to One Future*.[23] They have recently introduced the term Return on Customer. "ROC equals the sum of a firm's current-period profit from its customers, plus any changes in customer equity (the sum of the lifetime values of all current and future customers

served by a firm), divided by the total customer equity at the beginning of the period," they explain.[24] The centrality of customer-focused measures of profitability and lifetime value also is reflected in the work of Larry Seldin and Geoffrey Colvin. In their book *Angel Customers & Demon Customers*, they argue that "virtually every company in every industry will soon have to rethink its way of doing business along these lines, with customers at the center."[25]

CASE STUDY: HARRAH'S BETS ON RIGOROUS MEASUREMENT

One way Harrah's Entertainment has been able to transform itself into a leader in financial performance within the gaming industry is through the rigorous, enterprise-wide performance measurement of its marketing programs. How, wondered its critics, could homely Harrah's compete against the captivating visual experiences promised by its competitors on the Las Vegas strip? The answer, it turns out, was through an intensive, analytical focus on marketing investments and customer relationships.

In years past, Harrah's has launched a set of loyalty programs known as "Total Gold" and "Total Rewards," enabling it to provide deeply personal service to customers and track their behavior in extremely sophisticated ways. In fact, Harrah's can track individual casino and hotel guests across all of its properties (26 casinos in 13 states). This enables the organization to actively monitor individual levels of play and other activities, analyze preferences and interests, assess lifetime customer values, and provide personal offers or services based on those observations.

Through such efforts, Harrah's found that 26 percent of all customers generated 82 percent of overall revenue. However, it also learned that its most profitable customers are not necessarily the high rollers to which all the other casinos attentively cater. They turned out to be "former teachers, doctors, bankers, and machinists—middle-aged and senior adults with discretionary time and income who enjoyed playing slot machines."[26] Instead of rewarding these clients with steak dinners and stage shows, Harrah's found they typically were more inclined to appreciate a $60 stack of chips so they could dive right into the games. Many also valued the luxury of being expedited through lines or receiving differentiated customer service, and took steps to achieve Platinum or Diamond status.

The careful monitoring of gambling and other activities within the casino has been a critical part of the company's efforts to ensure that its resources are being intelligently invested. The reward cards ensure that nearly all activities are tracked. Harrah's can use this insight to present personalized marketing and service offers that reflect preferences and priorities down to the individual level. The organization also closely watches satisfaction scores. It knows through experience that customers that have a good experience increase their spending on gambling by 24 percent a year, while those who are disappointed decrease spending by 10 percent per year.

At a higher level, the company looks closely at same-store revenue growth and "cross-market" revenues that is, revenue growth across properties and geographies. It also looks at growth relative to other competitors within its various markets. "We've not only grown revenues," says John Boushy, Senior Vice President of operations, products, and services at Harrah's,[27] "We've also grown the percentage of cross-market play by managing the customer relationship. We recognized that there was a customer segment that traveled to multiple markets. We believed that if we could extend the relationship with our customers from one property to the entire brand we would be able to capture a greater share of their wallets when they went to other markets, and that is what happened."

CASE STUDY: ROYAL BANK OF CANADA INVESTS IN MEASUREMENT

Central to the overall measurement process of many firms is the necessity of computing customer profitability and customer potential. One company that invested heavily in this effort is Royal Bank of Canada.

Royal Bank is Canada's leading financial services firms with five lines of business: retail banking, insurance, wealth management, corporate and investment banking, and transaction processing. Headquartered in Toronto, the bank has 23 million retail accounts, 700 products, 58,000 employees, and has served 10 million corporate and public sector clients in North America.

The bank has been refining its understanding of customer profitability since the early 1990s when it learned that 20 percent of customers accounted for 100 percent of profit. The company's profitability model employed a three-tier system, recognizing whether customers were highly profitable, moderately profitable, or not profitable at all. It was a relatively unrefined system that helped direct the resources of the sales force and laid the foundation for future evolution toward customer-focused management. However, the system was not sophisticated enough to allow for relationship-based pricing, channel optimization, or to reflect the potential value a customer might contribute.

Richard McLaughlin, who was hired to lead the bank's CRM initiative, sought a "more robust profitability measurement" system and deployed NCR's "Value Analyzer" software in the late 1990s to help the company attain its objectives.[28] This accelerated the calculation of profitability figures which was critical in the bank's high volume, high complexity environment. It also provided much more accurate information on customer "spreads" (the difference between the rate paid to depositors and the rate charged to borrowers), potential risks, and transaction costs, all contributing to a far more accurate understanding of the variances in customer profitability.

Still, the approach was not enough. "We came to understand that customers can be both profitable and have the potential to be profitable, and that the bank needs both kinds of customers," said Gaetane Lefebvre, Vice President of Strategy Marketing Research and Analytics (SMR&A) at Royal Bank.[29] "Our new strategy was to look at our customers' total holdings and figure out how to deepen their relationship with the bank if they had potential. For example, were we losing opportunities to sell products to these customers? Are potentially profitable and profitable customers being lured away?"

With these goals in mind, the bank realized that truly valuable customer profitability models must incorporate activity based costing data (ABC) at the account or customer level. While the bank had been accumulating ABC data since the late 1970s, it was not until 1999 that the bank linked this data to customer profitability models. With that linkage established, the bank could assign costs to each separate product in a customer's portfolio, thus taking into account the transaction usage and channel preference.

With these capabilities in place, the bank began experimenting with measures of customer lifetime value. It approached this challenge in two ways. First, it assumed that the customer's current profitability percentile would remain constant through the lifetime of the relationship and calculated the net present value of profits. Second, it factored in demographic variables such as age, current products, and propensity to purchase new products. This enabled Royal Bank to calculate individual lifetime value scores and aggregate them up to the level of segment.

Based on the bank's ability to calculate current and potential profitability, it has been able to manage its marketing and service investments with far greater rigor than would otherwise be possible. In fact, the customer profitability calculations now guide the development of customized marketing campaigns, pricing arrangements, and the level of service that is offered.

The company's "decision engine" is central to its efforts to provide personalized attention to its customers. The engine contains several components, the most significant of which is based on four key predictive models: profitability, client credit risk, client vulnerability or attrition risk, and lifetime value. As Lefebvre explains, "Depending on how people rate for each model, they are placed in one of 14 categories, for which the bank will have a primary objective: to retain; grow; manage client risk; or optimize costs. We can then use these categories for marketing effectiveness, courtesy overdraft, allocation of rate discretion, and differentiated service."

The Royal Bank of Canada's marketing group has relied on the deep segmentation of customers, based on both profitability and propensity to buy, to generate its campaigns. Similarly, the bank is using its profitability and value measures to determine service treatment. Customer category assignments are used "to determine the length of wait time and the type of customer service representative that the customer talks to at our telephone-banking center," said Lefebvre. "We always want to ensure that our very best clients, in terms of profitability and lifetime value, get the very best service. That's how we retain good customers."

MARKETING MEASUREMENT'S LINK TO PROCESSES

Given the array of approaches and methods on offer, the measurement challenge, quite obviously, will remain a difficult and demanding one for some time to come. The best and most appropriate measures in the world, however, do not add up to much unless they are integral to marketing processes and are used to constantly improve performance. So it makes sense that we now turn our attention to the third of our performance dimensions, Effective Processes.