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How Do You Know to Spend LESS or MORE? – Measure Your Leverage

Discussions with CMOs and CFOs across industry groups seem to confirm that the most common methods of determining marketing spending levels are still:

- **How much did we spend last year?**
- **What percent of sales spent on marketing is most common in our industry?**

As the economy begins to recover, CMO thoughts once again turn to these metrics as they consider the prospect of spending increases. For some, leaping ahead aggressively in hopes of topline growth is exactly the right thing to do. But be careful: The quickest way to lose credibility as a CMO is to suggest that you need to raise your spending level to match competitors to maintain some equilibrium in "share of voice".

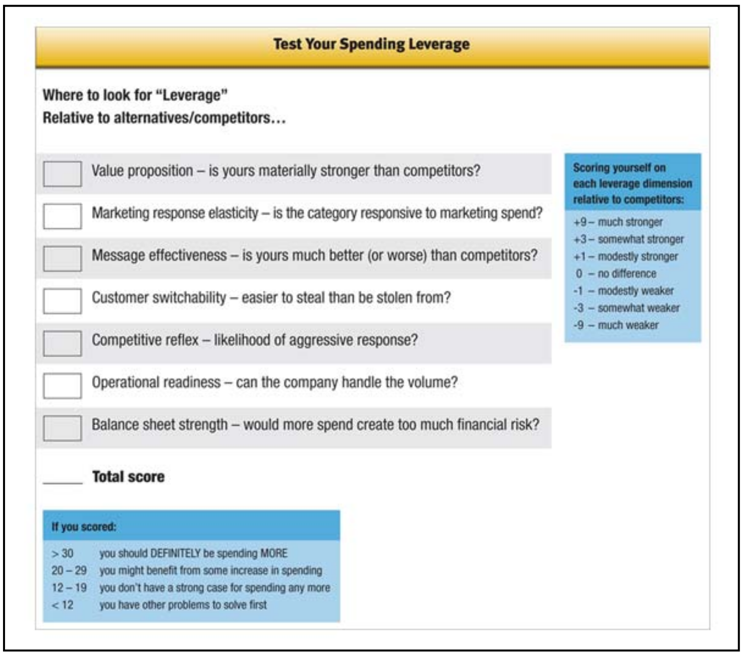
Most CEOs and CFOs see the foolishness of this logic. How, for example, do you know the competitor isn't making an irrational decision? What do you know about the effectiveness of your ad copy, value proposition, or market strength vs. theirs? How much ground would you lose if they outspent you by a substantial amount?

If you don't have specific answers to these questions, anecdotal evidence won't help. This is especially true now that CFOs, fresh off their cash crunch nightmares, are even less willing to open the spigot without a clear vision of ROI. Given the fresh memories of turmoil in most industries, CMOs need a different approach to defining the spend level that will satisfy their CFOs.

Very few CMOs use objective approaches to build budgets bottom-up from a list of desired business outcomes. Even fewer are employing any true analytical framework for identifying the "right" level of spend.

To make smarter budgeting decisions *and* build credibility with the rest of the senior management team, you need to set a strong foundation for your recommendation. In other words, you need better leverage.

Leverage will serve your efforts in two ways: First, it will help you create a comprehensive framework for more credible spending recommendations. Second, it will give you a leg up as business investments begin to flow again – and every functional or business manager jockeys to regain budget allocations that were sliced during the downturn.



Test Your Spending Leverage

Where to look for "Leverage"
Relative to alternatives/competitors…

☐	Value proposition – is yours materially stronger than competitors?
☐	Marketing response elasticity – is the category responsive to marketing spend?
☐	Message effectiveness – is yours much better (or worse) than competitors?
☐	Customer switchability – easier to steal than be stolen from?
☐	Competitive reflex – likelihood of aggressive response?
☐	Operational readiness – can the company handle the volume?
☐	Balance sheet strength – would more spend create too much financial risk?
____	**Total score**

Scoring yourself on each leverage dimension relative to competitors:
+9 – much stronger
+3 – somewhat stronger
+1 – modestly stronger
0 – no difference
-1 – modestly weaker
-3 – somewhat weaker
-9 – much weaker

If you scored:	
> 30	you should DEFINITELY be spending MORE
20 – 29	you might benefit from some increase in spending
12 – 19	you don't have a strong case for spending any more
< 12	you have other problems to solve first

Can You Use Your Mix Model to Determine Spend Level? Same or Different?

If you've used marketing mix models (e.g., regression analytics) in the past, you may think these tools are the best predictor of the expected return from various spend levels. Perhaps. But for this to be true, you have to pass a simple test. For each of the following questions, answer "same" or "different":

- Are the buying patterns in your category largely the same as they have been over the past few years, or are there different dynamics taking shape which influence who buys what and how much of it?
- Are the competitors in the marketplace the same or different?
- Are these competitors taking the same familiar competitive postures and positions, or are they acting differently than before?
- Is your marketing mix for the coming period the same, or are you introducing a different set of tactics?
- Is the relative strength of your message execution (compared to competitors) about the same, or is it different?

If you answered "same" to all five questions, chances are your mix model will guide you correctly toward the right spend levels (provided you have actually experimented with those higher spend levels before). However, if you answered "different" to any one of these questions, or have never spent at the levels you are now contemplating, the analytical tools that served you well in the past may not be up to the challenge of properly forecasting the outcomes for the future. In fact, they may actually be misleading you, delivering a "precisely wrong" direction.

A Better Framework for Spending Decisions

To build a stronger foundation for the "right" spending levels, we recommend following a 6-step process:

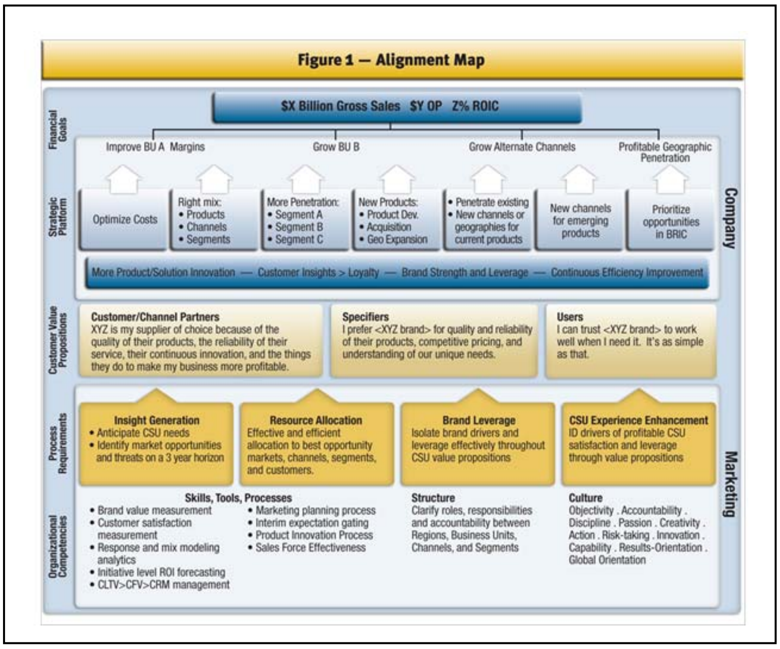
1. Ensure that you are aligned to the proper goals and objectives.
2. Make sure you've squeezed every drop from the current spend patterns.
3. Have a plan for how you will prioritize the new marketing funds <u>strategically</u>, not just tactically.
4. Identify the points of leverage you can exploit.
5. Demonstrate an understanding of how the business environment has changed.
6. Proactively assess the risk of your plans.

Each step will get you closer to your goal of credible marketing spend.

Step 1: Align to the Proper Goals and Objectives

As silly as it may sound, too many marketers still work against one set of objectives (brand preference, share growth, etc.) while the rest of the organization has migrated to another (margin enhancement, channel expansion, etc.). These disconnects happen most often when marketing fails to regularly ask, "Are we still focused on the right goals?"

You need to ask this question – every six months or so – in order to get your marketing aligned with the overall company goals as directly and clearly as possible. An Alignment Map (Figure 1) can help you achieve this alignment by documenting the relationship between shareholder value goals, company strategic platform, and the role marketing plays in establishing and delivering on customer value propositions.



If marketing isn't aligned to the right goals and objectives, no amount of spending will have the desired effect. So before asking the question, "How much?" make sure your CEO and CFO will agree with your answer to *their* question: "What are we trying to accomplish?"

Step 2: Squeeze Every Drop

Time and again we hear stories from CFOs about how the marketing team is looking for increased levels of investment behind strategies and programs whose returns are anything but clear. Not surprisingly, this approach raises the CFO's "good-money-after-bad" hackles. There isn't a CFO on this planet who doesn't believe that SOME portion of marketing spend is less productive (sometimes referred to as "wasted"), and thus a good candidate for cutting or reallocating.

So before you come in asking for MORE money, you should have a clear idea of the type of returns you're generating from CURRENT spend levels. Proactively assessing your current spend commitments can be extremely effective in helping you free up dollars to fund new initiatives.

There are two ways to identify "de-fundable" programs or initiatives: via standard business case process or a more qualitative quintile analysis.

Business case: Standardizing a process for business case analysis makes great sense for any organization at any time. By putting each and every proposed investment (over some threshold of "materiality") through a structured assessment of costs and expected benefits, the company gains in two ways:

- Programs with weaknesses in logic or those with high executional risks are more likely to be weeded out before getting any funding, and the ones that pass the screening are more likely to achieve their intended outcomes.
- Applying rigorous assumption testing creates an organizational knowledge base that builds over time, thus enhancing the company's ability to deploy more resources more effectively.

Setting up the business case template can be a bit challenging, as it needs to balance structure with flexibility and successfully compare many different types of initiatives on an apples-to-apples basis. But there are some excellent techniques and methods emerging in the marketing community to help you create the template.

Quintile analysis: If you don't have a standard business case process in place, quintile analysis can help you make some progress toward identifying candidates for de-funding. This process employs a simple scoring mechanism, whereby everyone in the marketing organization reviews a list of previously funded initiatives and scores each of them using non-linear ratings of 0 (no impact), 1 (minor impact), 3 (moderate impact) or 9 (significant impact). Each score must account for one-quarter of the total initiatives on the list (e.g., if there are 40 initiatives on the list, no more than 10 can be scored a "9"). This forces people to rate programs more thoughtfully, and creates differentiation between clear tactical winners and losers. (Figure 2)

Figure 2 — Pruning Current Programs to Free-Up Budget

Initiative	$000s	Score	
Brand ad campaign	4000	88	
Zephyr product launch	2250	74	
Paid search ads	487	71	
Sales enablement training	1200	62	
Midwest channel incentive program	2295	58	
Direct mail to influencers	780	56	
Social media	372	47	
Intergalactic trade show	840	23	Drop these programs
Football stadium sponsorship	245	16	
Vertical sector advertising	1130	12	

Once all the scores are in, add up the totals for each initiative and then rank the initiatives from highest to lowest. The bottom 20% or so of initiatives are usually good candidates for de-funding.

Regardless of which of these two methods you employ, this type of analysis is an effective gesture to gain credibility by freeing up current expense dollars.

Step 3: Develop a Strategic Prioritization Plan

Strategic prioritization means having a clear view into which geographies, products, channels, or market segments you will allocate more or less money. This can be tricky in an organization where, for example, regional leaders or business unit heads are allocating marketing budgets from their own P&L as a complement to corporate funds. Yet it is EXACTLY this situation that requires a strategic prioritization if corporate resources are to be used to maximum benefit.

Most of the techniques for strategic prioritization on geo/channel/product/segment levels are forms of portfolio management in which options are identified, prioritized based on an assessment of the potential return, and then funded accordingly.

For a strategic process that guides resource allocation to be credible, everyone involved must be clear about the components and calculations used and their impact on results. The data collection, analysis and review process also needs to be transparent and must maintain a balance between structure and flexibility. And, given the politics inherent in any large company, the resource allocation process must be perceived as unbiased across constituencies and power bases.

Getting incremental resources is always easier if you can state precisely where you'll be spending it for greatest impact. Having a strategic prioritization clearly defined demonstrates good focus and an understanding of exactly how to help the business.

Step 4: Look for Points of Leverage

CEOs, faced with competing requests for resources every day, are always looking for "leverage" – places where the return on investment is potentially large and realized quickly to generate cash flow to fund accelerated growth. Unfortunately, marketers often overlook similar opportunities to exploit points of leverage when building a case for more spending.

The concept of leverage is straightforward: Where can I spend a dollar to get the best returns for my efforts? There are several places where marketing can look for leverage points that suggest more spending would be beneficial:

- Value proposition: What is the relative strength of your product/service value proposition vs. your competitors? If you believe (or better yet, KNOW through customer research) that you have a relative and meaningful value advantage that can be furthered by increased marketing spending, then spending more might be the right thing to do.
- Message strength: How strong are the relevance, clarity, and distinctiveness of your message, and can you defend it from copycat claims? Using a variety of classic copy-testing techniques, you can make an argument to spend more on advertising to leverage the strength of your message.
- Marketing response elasticity: Is your category going to be responsive to more marketing spending, or does it require additional or different types of stimulus (e.g. more direct selling) to shift the status quo? If you're not sure, then it's best to experiment on a smaller scale with higher spend levels before you jump off the cliff.
- Customer switchability: Are profitable prospective customers more likely to jump to you now, or are you more likely to attract cherry-pickers who will bleed your margins? Can you tell the difference between the two? What is your current share-of-customer? If it's high, you may not have much upside amongst your loyal base, which would cause you to bet on the ability either to steal customers from competitors or attract new customers to the category. How easy are these prospective converts to identify? How willing are they to switch? The barriers to attraction generally get higher and more costly to overcome as you penetrate the market more deeply. The incremental lift per dollar spent may be lower than your historical averages.

- Competitive reflex: Are you the dominant market share leader? If so, the marginal cost of each additional share point may be much greater, assuming you can wrest it away from another established player. Alternatively, if you are a minor player trying to steal share from larger competitors, be sure you have a clear vision of the true cost – not just for gaining share, but also for maintaining it when they react (which they usually do). Plan for these reactions. You don't want to get caught with all your cash on the table if they haven't played their first card yet.

- Operational readiness: Are you operationally ready to serve the new business you hope to attract through increased marketing spend? Is your supply chain in order? Do you have the right resources to provide the necessary customer experience to realize the potential value you went after? If you thought the cost of acquiring customers was high, wait until you have to re-acquire the ones you couldn't serve well.

And finally, if you score yourself high on all of the above dimensions, don't forget to check…

- Balance sheet strength: Does the company have the cash resources to fund an aggressive escalation in marketing? Would further marketing spend increase the company's overall risk exposure beyond a reasonable point? If the marketing effort failed, would it seriously harm the company's financial viability? If you don't know, find out BEFORE you recommend spending more. You don't want to have the executive committee tell you that your spending proposal is well conceived, but poorly timed. In technical parlance, this is known as a "career-limiting outcome."

If you don't feel you stack up strongly in at least two of these areas relative to your competitors, you probably don't have enough leverage to justify increased spending. But if you do, then your case just got much stronger. (Try taking the Spending Leverage Test in the sidebar to see how you rate).

Step 5: Assess the Business Environment

Even if you have clear leverage opportunities, the business environment is powerful enough to neutralize just about any unilateral effort a given company might make. Sudden swings in the macro-economic spectrum or the regulatory environment could have you spending into an impenetrable headwind and dramatically reduce the expected impact of your investments.

This is why marketers need to understand the real drivers of the business environment they're operating in. What are the issues that could create the strongest headwind (or tailwind) for you?

Many marketers focus on GDP as a measure of the economy – but GDP does not correlate well with marketing dollars. Interest rates, however, are a different story, as are employment rates, since both impact consumer buying patterns. Other economic indicators to consider:

- Housing starts, particularly if your company is in the home supply, furniture, or construction, or related sectors.
- Currency rates for all the markets in which you compete. How the Yuan is trending, for example, is a significant issue for companies sourcing products from China or selling products into China.

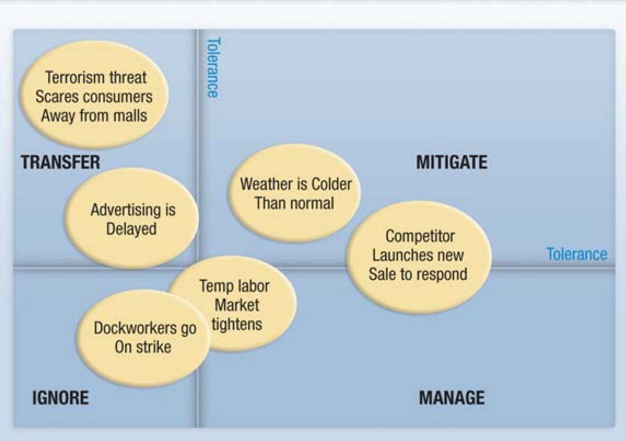
- Solar energy adoption, organic food consumption, or other socioeconomic trends that could have significant impact (positively or negatively) marketing spend.
- Consumer confidence rates or other indicators of marketplace sentiment.

Step 6: Assess the Risks

Marketers are notoriously bad at identifying (or sharing) everything that can go wrong with a marketing program. But everyone in finance knows this, so ignoring the risks undermines their confidence in you. On the other hand, proactively assessing risk and planning for different scenarios establishes credibility with finance and others in positions to comment on your proposals.

A good risk assessment begins by identifying any factor – internal or external – that can screw up your plan. If necessary, find the person on your team who's the best at seeing the dark side of everything (every team has one) and ask them to create a comprehensive list of possible problems: a new competitor entering your market, a delay in the launch of an ad campaign, even changing weather patterns. As you identify these risks, rank them in terms of potential impact and the relative probability of them happening. You'll end up with a matrix based on low/medium/high probability and low/medium/high impact. (Figure 3)

Figure 3 — Marketing Risk Management Matrix



For high-risk, low-probability issues – a local terrorism attack, for instance – look for ways to transfer the risk to third parties (e.g., buy purchasing terrorism insurance). For low-risk, high-probability issues, make sure there's a plan in place to mitigate the risk. If you identify any high-risk, high-probability scenarios related to your plan, then STOP. You need to rethink the entire plan until you determine how to lower the risk or decrease the probability of it happening.

Proactively identifying risk around your marketing plans will give finance far more confidence in the areas where you're asking to increase spend.

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Economic recoveries eventually require senior management teams to address a significant amount of pent-up demand, both internally and externally. Business units and functions all have their hands out, jockeying for funding to invest in growth programs that were put on ice during the downturn. Anticipated demand from customers increases the urgency to add new plants or capacity.

At the same time, however, the standards for risk-adjusted payback are much higher than they used to be. CMOs who find themselves competing for still-scarce resources will have to build a better case for their programs as the most attractive option for achieving business growth. Although traditional tactics, such as sowing fear and doubt around competitive pressures, may get you the spend levels you're requesting in the near term, the memory of your tactics will undermine your career progression for years to come.

A more disciplined approach to spending recommendations, following the framework described above, will improve the chances that your proposal will win on the merits of a comprehensive analysis that builds trust and credibility with the CEO and the CFO.

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