



## Connecting Marketing Metrics to Financial Consequences

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Marketers are happy speaking their own language, replete with jargon like "awareness," "share of requirements" and "customer satisfaction." Such terminology works fine in the marketing department and with the advertising professionals who execute marketing plans. But there's a translation problem between that language and the language of profitability and stock price which is the mother tongue of corporate CEOs. "CEOs want to know what a 5% increase in customer satisfaction will do for the bottom-line," says Wharton marketing professor [David Reibstein](#), adding that "we need to draw a connecting line" between concepts of the two languages.



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Reibstein offered a primer on how to make those connections in his talk – entitled "Linking Marketing Metrics to Financial Consequences" – at the Wharton Marketing Conference on October 15. He pointed out that marketing metrics has been the top research priority for the past six years of corporate marketing professionals polled by the Marketing Science Institute. "In this economic environment when corporate budgets are being squeezed, Chief Marketing Officers are kept up at night by worry, trying to justify their expenditures and their existence. They believe what they are doing has value, and they have to figure out how to demonstrate that value" to skeptical CEOs and CFOs, Reibstein said.

An important step in that direction is quantifying the value of a firm's key intangible assets, such as the value of a customer and the value of brand awareness. Reibstein started out his discussion about the value of customers by showing the contrasting financial history of two companies. Both Company A and Company B had the same stable profit for the last five years. Company A had spent far more on marketing than Company B and its revenues had grown faster, but not as fast as its marketing expenditures. As a result, Company A's return-on-sales had dropped compared to Company B. Reibstein then asked his audience which firm had been doing a better job.

Most participants felt that Company B had been doing the superior job, and so did the vast preponderance of a group of CFOs to whom Reibstein had recently posed the same question. Company B got their votes by apparently "doing more with less" – in other words, by providing stable profitability with less marketing expenditures than Company A.

But Reibstein applied an x-ray, so to speak, to the financial data by next showing data on the customer relationships developed by the two firms. It turned out that Company A had three times as many customers as Company B. "So it becomes really important how to value that asset," Reibstein suggested. And, in fact, there is an equation for just that purpose. It calculates the cost to acquire the customer, the amount of the company's product that the customer purchases, the profit margin of those purchases, the cost of retaining the customer, the actual retention rate, how that customer influences others and the cost of capital.

Lo and behold, the audience learned that Company A not only had a tremendous increase in the number of new customers, but its "churn rate" (the rate at which it lost customers annually) was much lower. So when the formula to value customers was applied to firms A and B, the value of Company A's customer base was four times that of Company B. Maligned Company A was actually doing the right thing all along by spending heavily on marketing. "Valuing a customer base is something a straightforward financial statement doesn't do," said Reibstein. "And that's why financial statements can lead us astray.

They require us to expense all marketing expenditures the year they occur, when actually, customer relationships have a life for a corporation."

Reibstein pointed to studies showing that 50% of corporations' value today is composed of intangible assets, up from just 20% 40 years ago. And it is primarily these intangibles, not hard assets, that dictate a company's valuation by the stock market. Among those intangibles, intellectual property probably ranks number one in value, but Reibstein believes that the value of customers is likely number two. "A customer base represents a future revenue stream, and we sell ourselves short if we don't articulate its long-term value."

Valuing customers also can be a useful way to set a hypothetical ceiling for marketing expenditures. Reibstein showed the results of research that calculated the value of customers of leading consumer brands such as BMW and Coca-Cola, taking into account, for instance, how likely a purchaser of a BMW is to purchase another BMW. By those formulas, BMW's customers are worth a hefty \$143,500 and Coca-Cola's a respectable \$1,200. An address earlier in the day by a top Coca-Cola marketing executive had made the point that drinkers of Diet Coke are more loyal to that beverage than are drinkers of regular Coca-Cola. "So that would indicate you would spend more to acquire Diet Coke drinkers," versus regular Coke drinkers, said Reibstein.

Reibstein then turned his attention to the value of retaining customers. In his comparison between hypothetical companies A and B, Company A kept its customers for five years, while Company B kept its customers for only two years. That gave Company A a huge advantage. CFOs often worry endlessly about the cost of capital, but actually the retention rate of customers is far more important, said Reibstein. He used a sensitivity analysis to illustrate his point, showing, for instance, that an improvement in customer retention rates from 60% in 70% has a more favorable impact on revenues than chopping the cost of capital from 16% to 10%.

Brands are another asset that marketers need to do a better job of valuing, said Reibstein. There are unfortunately many competing methodologies to value brands, but a standard way is likely to emerge because the Financial Accounting Standards Board is working on the problem. According to one methodology, Coca-Cola is the world's top brand with a value of \$67 billion, Microsoft number two at \$61 billion and IBM number three at \$53 billion.

The value of brands is intricately tied up with the value of advertising, of course. The data that looks at the short-term impact of advertising of sales "is pretty discouraging," said Reibstein. For instance, a study on "advertising payback" showed that consumer packaged goods companies got back only \$.54 of increased revenue for every dollar they spent on advertising. "Most firms that cut advertising don't see an immediate drop in sales." Yet there is also no doubt that stopping advertising over the long-term will do irreparable harm to a brand. "There's not enough good research on how fast brands atrophy," Reibstein noted.

His final example of the financial consequences of marketing effort concerned the issue of customer satisfaction. "We need to understand what it costs to improve levels of customer satisfaction and what it is worth to a company to have highly satisfied customers," said Reibstein, adding that it is possible to have paradoxical results in this area: In other words, consumer satisfaction can go up, yet profits and market share go down. "That can happen if the company is so focused on consumer satisfaction ratings that it gets rid of dissatisfied customers."

Still, in many instances it proves to be worth spending millions to increase customer satisfaction. For instance, Starbucks Coffee faced a dilemma caused by its success. The long waiting time for service was reducing customer satisfaction. Yet to increase staff to reduce waiting times would cost \$40 million. An analysis of customer satisfaction found that unsatisfied Starbucks customers stuck with the chain for just one year, made 47 visits per year and spent a total of \$200. By

contrast, highly-satisfied Starbucks customers patronized the chain for more than eight years, made an impressive 86 visits per year and spent more than \$3,000 dollars over that time. The leverage provided by improving customer satisfaction was so powerful, it was easy to decide to spend the money on increased staffing. While not every use of a marketing metric may make marketers so happy, as tools they are capable of conveying a powerful message to CEOs and CFOs.

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