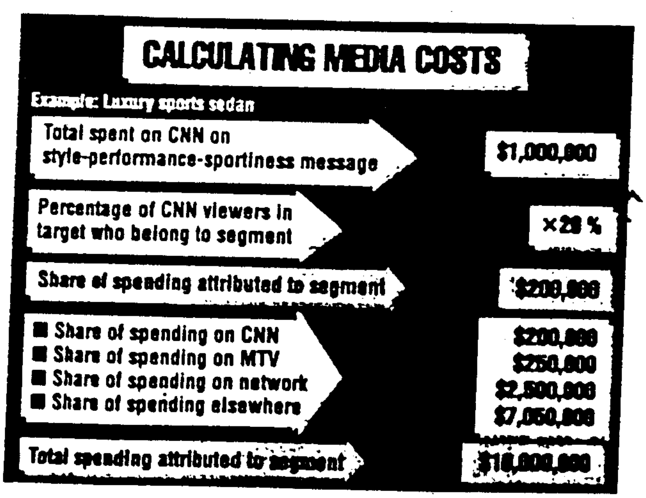
# Do Your Ads Work?

THIS RATIO DEFIES RATIONALISATION. EVER since the dawn of advertising, CEOs have tried to measure the exact returns from their ad-spends (a.k.a. ROA), only to fall prey to a fundamental debate. Just how should the payoffs from advertising be calculated? Should the indicator be sales volumes? Is it more meaningful to measure brand equity? Or is the consumer recall of an advertising campaign the right yardstick? Cutting through the controversy, Naras V. Eechambadi—a consultant at McKinsey & Co.'s Stanford office—has created a model that not only makes it possible to calculate the ROA, but also shows how the ROA can be leveraged to use advertising budgets better. BUSINESS TODAY presents an excerpt from *The McKinsey Quarterly*, that exclusive journal where the collective wisdom of the specialists from the world's biggest and best-known consulting firm is recorded.

DESPITE THEIR HEIGHTENED attention to advertising spend (ad-spend), managers still have a hard time getting it precisely right. This should occasion no surprise: the task is extremely—perhaps even impossibly—difficult. There are problems everywhere: data are often unreliable, internal accounting and control systems irrelevant, performance criteria inappropriate, budgets unpredictable, time horizons for decisions unclear or unreasonable, and managerial incentives unfocused.

These problems do not remove the burden of getting it right. But they do redefine a bit the yardstick by which "right" gets measured. Greater accuracy and precision are, of course, always welcome. But the primary merit of any new approach to making decisions about ad-spend is to embed throughout an organisation a consistent, shared discipline for systematically thinking through the complex dynamics of value creation and capture.

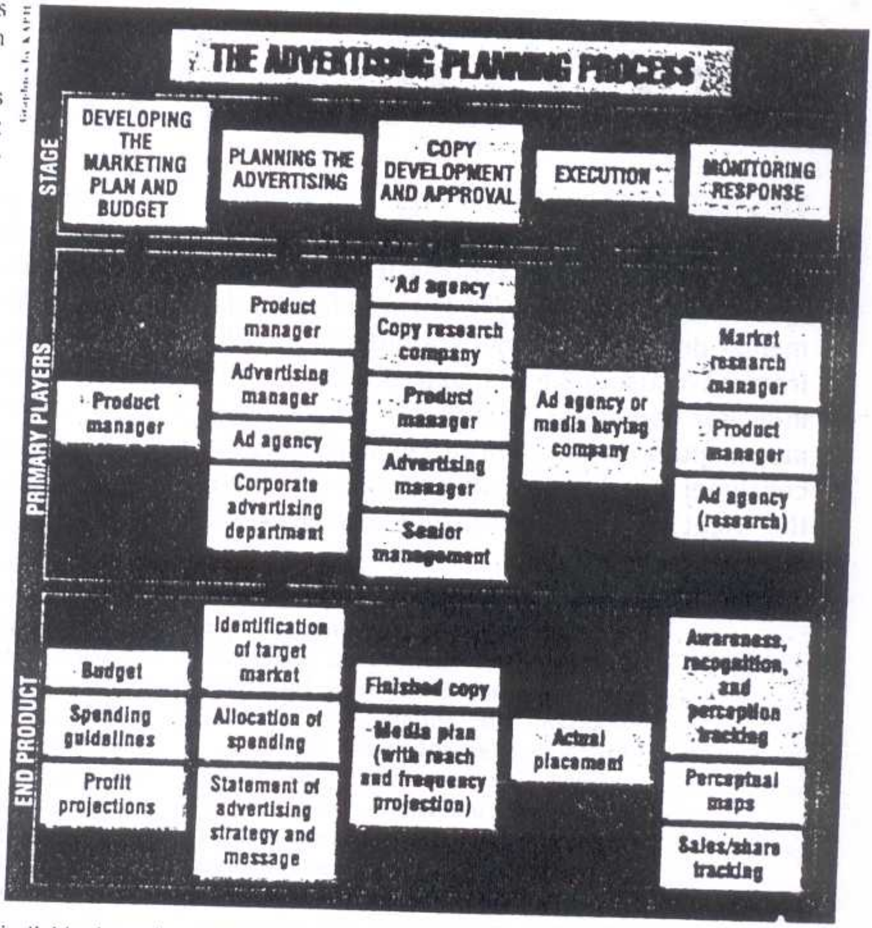



Such consistent discipline is especially important given the relatively fragile state of knowledge about the true economic value of advertising. There are, for example, a couple of facts about advertising that almost everyone knows. For much of the 1980s, ad-spending boomed at a double-digit clip. Then, in the 1990s, expenditure began to decline in real terms. Among managers, as well as students of advertising, two competing theories have developed to explain these conflicting trends:

- Advertisers were overspending during the 1980s, or they are underspending today. Or both.
- Either (or both) rate of spending is right; it is simply that the nature of competition, the overall performance of the economy, and the role of advertising have all changed from one decade to the next.

Both theories are plausible and popular. Both are wrong. In fact, there is a third explanation: ad-spend has become so disconnected from economic reality and from an understanding of how best to evaluate an ad's quality—that is, its creativity—that these numbers do not reflect much other than management's willingness to open its wallet.

New approaches to thinking about advertising that are anchored in the effective metrics of creativity and in the economic reality of value creation are, therefore, needed. The one described here focuses on the economic half of this equation. Based on existing market research techniques and information technology, which have eased tremendously the execution of such approaches, it provides managers with a rational, dependable tool for setting advertising budgets and monitoring advertising effectiveness. It also allows them to see how their products deliver value to individual market segments and learn how advertising can communicate this value to the consumer. Most of all, it helps to clarify the relationship between a unit of media spend and a unit of economic value.




Many companies are adopting bits and pieces of this approach although, to date, no large advertisers use it systematically. They tend to direct their approach towards the market as a whole—and not towards the multiple segments that they want to reach. Even so, they have all found genuine benefit in the disciplined thought process that it helps to create and institutionalise.

## A different model

IN MOST COMPANIES, SENIOR MANagement gives each brand manager his or her ad-budget for the year. The budget is generally based on last year's plus or minus a few per cent. The brand manager then works with ad agencies and is free to spend the budget, more or less, as he or she pleases—within, of course, the sharp financial constraints imposed by the need to deliver against tough year-to-year profit-and-loss accounts.

This new approach works differently. It should be familiar to senior managers because it resembles the standard capital budgeting process that operates outside advertising. Instead of being handed budgets from above, brand managers tell senior managers how much their budget should be. They are allowed to spend as much as they want on advertising—provided the ROA can be shown to beat some internally-agreed hurdle.

There is no reason why senior managers should not be able to answer the economic portion of the simple question underlying all advertising: does my advertising work? If you cannot prove that

**Ad-spend has become so disconnected from economic reality that the numbers reflect only a company's willingness to spend**

### FROM OBJECTIVES TO INCREMENTS

Example: Luxury sports sedan

| | | |
|---|---|---|
| Targeted change in perceptions | | 6.7 % |
| Impact on consideration | × 1.5 = | 10.0 % increase in consideration |
| Conversion to showroom visits | × 0.5 = | 5.0 % increase in probability of showroom visit |
| Closing rate on showroom visits | × 0.10 = | 0.5 % increase in probability of purchase |
| Size of segment | × 500,000 = | Increment of 2,500 in no. of cars sold |
| Marginal contribution per car | × $5,000 = | $12.5 mn net incremental contribution from advertising to segment |

the dollars you spend create economic value by persuading consumers to purchase your product, you should not advertise—period. On the other hand, if you can prove effectiveness, the answer may well be to put more spending behind successful campaigns for successful products in the right segments. The absolute size of the ad-budget is not the point. Under this new way of thinking, issues of creativity aside, no ad-budget is too large provided it produces positive economic returns on the capital invested.

This will not, of course, solve all the measurement problems associated with advertising. There is, as noted above, a substantial creative element that does not lend itself to the same kind of hard measurement that applies to financial analyses. Nor does it address the issue of long-term impact—although, by logically modelling the way advertising works, it makes it easier to estimate the likely long-term effects than do current econometric approaches that rely on statistical chance. Nor is it necessarily the best way of proceeding in all circumstances. In most situations, however, it represents a substantial improvement over current practice where the lack of proven techniques has meant that little or no effort has gone into measurement.

**If you can't prove that the money you spend persuades consumers to purchase your product, don't advertise. Period**

This approach works by forcing the whole of advertising to be more accountable than it traditionally has been and, consequently, increasing the level of confidence in spending decisions. Available resources are committed to better options. Most important of all, by laying bare the whole process, it exposes advertising strategy to examination and transforms it into a logical, step-by-step, bottom-up enterprise rather than a top-down activity vulnerable to the whims of all those in management who fancy themselves as advertising critics.

## What happens now?

HOW DO MOST CONSUMER COMpanies typically plan and execute their advertising? In general, financial planning drives the process of determining ad-spend for existing brands. An overall marketing budget is often set during an annual planning routine, which starts with revenue and profit targets and progresses to volume targets and pricing guidelines. A carefully-managed process then allocates funds to the more tangible levers of marketing, such as trade and consumer promotion, with specific targets for, say, cases shipped or levels of redemption. Whatever is left over at the end is assigned to advertising. The ad plan is often developed jointly by the marketing manager and the ad agency's account management. Its main elements are the primary message or theme of the campaign, positioning guidelines for execution, the definition of the target audience, and indications of media vehicles to be used.

Many advertisers have general communications objectives—such as increasing or maintaining awareness—but set quantitative targets all the same. The image, or positioning, of a product tends to be driven by how management would like the brand to be perceived, or by its heritage, rather than by an understanding of the links between positioning, the resulting perceptions, and their impact on the behaviour of distinct segments. The need to adapt positioning to the differing needs of individual segments is often acknowledged, but rarely acted upon. A unified positioning can work only for a brand that appeals to a specific segment.

There is a tendency for key decisions in the development of an ad campaign to involve too many players, some of them ill-informed and inexperienced. Copy may be tested using syndicated services that measure a commercial's ability to attract attention and break through the clutter. This means using yardsticks such as recall, recognition, and persuasion, but ad managers seldom calculate how well the copy actually succeeds in communicating the message and achieving the desired change in perception.

Recall and recognition scores, for example, are inappropriate when the aim of the copy is to change the audience's perceptions because a commercial that is widely remembered and recognised by consumers may not actually succeed in changing their perceptions of the product or service. Perceptual maps or image engineering techniques, which would be appropriate for measuring changes in perception, are used occasionally to help determine positioning strategy, but rarely to track changes in perception or to test advertising copy.

The weakest link in the advertising process is in the delivery of the message to the target audience. Although it is possible to pinpoint an audience or readership with great accuracy, advertisers, agencies, and the media have traditionally been content to buy and sell on the basis of broad demographic groupings.

Agencies and advertisers will often expand their original precise definitions of their target audience to correspond to the more broadly-defined television or magazine audiences. Despite the waste, this can sometimes be justified since it is hard to make the numbers add up with a splintered media strategy. More often, however, this approach is money down the drain. Its roots lie more in the cost and compensation mechanisms built into the advertiser-agency relationship than in genuine cost efficiencies or effectiveness.

## Monitoring response

MOST COMPANIES HAVE MONITORing systems that are static: they continue to measure the same indicators over time. Action standards are not always adjusted to reflect changes in what the copy is intended to achieve. Maintaining awareness and ad recognition, for instance, may continue to be treated as key benchmarks even when awareness has ceased to be an objective. Usually, this happens where the linkage between communication objectives and sales is not understood.

**Ad managers seldom calculate if the copy is communicating the message and achieving the desired change in perception**

If changing perceptions or reinforcing brand loyalty are key objectives, specially-designed market research can be used to measure whether the advertising has achieved the desired effect. In regular tracking studies, however, managers often neglect this option for fear of losing historical comparability. Given sufficient forethought and planning, though, it is possible to satisfy both aims and to change tracking studies gradually so that continuity is maintained without sacrificing relevance.

### WHY TARGET ?

**The trend towards ever-tighter targeting of advertising emerges from a number of developments:**

**MARKETING PROBLEMS**
Consumer fragmentation, the maturing of product categories (especially in packed goods), decreasing customer loyalty, the threat of private labels in mass market segments, and increasing media clutter are all conspiring to make traditional mass marketing approaches less effective

**DESIRE FOR EFFICIENCY**
Against a background of increasing media cost, the realisation that much current spending is wasted on non-target customers, coupled with the emergence of better targeting techniques, makes targeting a more attractive goal than it used to be

**DESIRE FOR MEASURABILITY**
Setting specific objectives and measuring results is much easier to achieve on a segment-by-segment basis. With the existence of large customer databases, such segmentation need add little cost or complexity to the tracking process

**MEDIA FRAGMENTATION**
The growth of cable and special-interest publications has already fragmented the major media. This trickle will become a flood with the spread of cable channels, interactive TV, and other electronic media. Companies may have to rethink their entire approach to advertising and media placement

**INFORMATION TECHNOLOGY**
The capacity to capture, store, access, and analyse vast quantities of information about customers and their behaviour at a reasonable cost has made it possible to segment and target customers more finely than ever before

## A more targeted approach

SO MUCH FOR THE CURRENT STATE OF the game. How should a company set about advertising in the emerging environment? The answer lies, in large part, in redesigning internal processes to be consumer-driven and much more targeted, with financial results acting as benchmarks for decision-making rather than as the starting point of the planning process. A confluence of factors is driving the trend towards more targeted media strategies: the emergence of new marketing problems, fragmentation among consumer segments and within the media, the availability of better measurement and analytic tools, and the desire for greater efficiency and measurability.

The first step in the transformation to the new approach for measuring ad-spend is to define segments tailored to communication needs. Next, communication objectives must be linked to business goals. Finally, advertising must be valued, component by component, for each segment. Such a framework is applicable to most products or services, but to illustrate the process, let us examine a hypothetical campaign for a luxury sports sedan.

**The weakest link in the advertising process is in the delivery of the message to the target audience, which can be accurately pinpointed**

**DEFINE RELEVANT SEGMENTS:** For advertising purposes, segmentation must focus on grouping consumers together with their media habits. Media segmentation is typically carried out along a single dimension, such as demographics (women between 25 to 44 years) or behaviour (frequent fliers). Combining a variety of additional segmentation bases (such as attitudes and benefits) with the traditional information on demography or geography, and entertainment habits (movie-going, video-tape rental, premium and basic channel viewing) can, however, yield smaller, much more sharply-defined segments.

These segments could be targeted with specific products such as customised pay-per-view packages offered by local cable companies. For media purposes, such segments need to be split further into groups that share media habits. In the sports sedan example, one of the key segments is households that currently own a three- to five-year-old Japanese compact sedan which they plan to replace in the next six months, that have a household income exceeding $60,000, and that subscribe to CNN.

**DEVELOP SEGMENT OBJECTIVES:** The next step is to identify the critical attributes of the product or service and their relative importance to the chosen segment. Primary research, and such common techniques as regression analysis or somewhat more complex approaches such as conjoint analysis, are often used. The segment's current perceptions of the product or service also have to be calibrated. Returning to the sports sedan example, we know from existing market research that perceptions of style, performance, and sportiness are considered equally important by the target group, and that each of these is twice as important as comfort, safety, and durability—factors that would probably be more critical for a family sedan.

Once the critical attributes have been identified, realistic targets—based on past experience and actual product performance—can be set for improving the perception of them. In our example, a reasonable target might be a 10 per cent improvement in perceptions of style and a five per cent improvement in performance and sportiness, two related dimensions.

**LINK OBJECTIVES TO INCREMENTAL CONTRIBUTION:** Here lies the key to making this approach work. The relationship between advertising and sales can be highly complex, often taking the form of a long causal chain with both risks and opportunities at every link. Each specific case needs to be modelled afresh; both the conceptual model and the parameters that indicate the relationships between links can vary by situation and segment. All the same, a comprehensive monitoring programme can capture these relationships on a continuous basis, and research similar to that used for identifying the

### AD BUDGETS: THE OLD VERSUS THE NEW

| OLD | NEW |
|---|---|
| Apportionment based on the previous year's spending | Apportionment based on return generated by advertising |
| Allocation imposed from above on the brand manager | Allocation made on the basis of brand manager's requirements |
| Ad-spend determined by annual profit and loss accounts | Ad-spend determined by the ability to meet internal targets |
| No measurement of economic value added by advertising | Formal measurement systems for creativity and value creation |

importance of attributes can be employed initially to build the models.

Again, let us see what this stage entails by looking at the sports sedan example. Our targets were improvements in perception of style (10 per cent), performance (five per cent), and sportiness (five per cent). Averaged out, the overall target becomes a 6.7 per cent change in perceptions. The impact of this improvement is a 10 per cent increase in the probability that the target segment will consider buying this car.

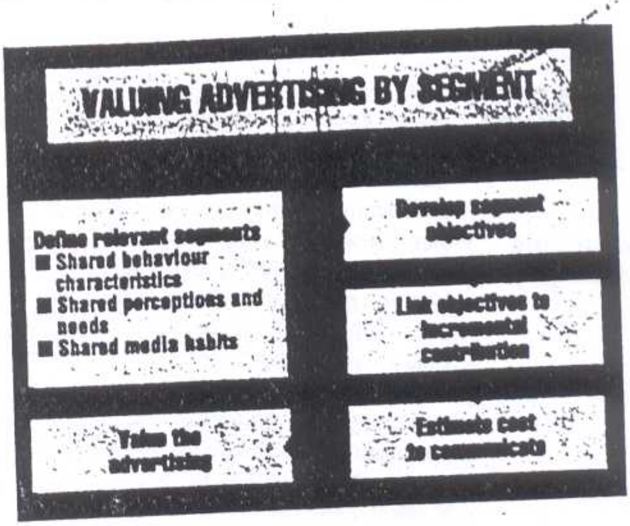
Since half of those considering buying cars are known to actually visit a dealer—while the remainder may be pre-empted by a competitor, not live near a convenient dealership, or postpone the purchase—this, in turn, brings a five per cent increase in showroom visits. Both consideration levels and dealership visits can be monitored periodically at the segment level to verify the validity of this model.

If 10 per cent of dealer visits are converted to actual sales—again, a number that should be readily available with proper monitoring—the result is a 0.5 per cent increase in sales to this segment. Multiplying by the size of the segment (500,000) and by the margin per unit ($5,000) yields a net incremental contribution of $12.5 million from advertising the message of style, performance, and sportiness to this segment.

**ESTIMATE COST TO COMMUNICATE:** Since the media is often bought for segments larger than a targeted approach requires, this is probably the most difficult step in the sequence. But once mutually exclusive segments have been defined, the total cost of buying a particular media vehicle can be divided among them in proportion to their weight within the wider target group for that vehicle.

In the example, if the total spent on the style-performance-sportiness message on CNN was $1 million, and this segment represented 20 per cent of all of the target segments who watch CNN, then the cost attributed to this segment is $200,000. Aggregating costs for the campaign over all media yields an estimate of the total cost of communicating this message to this segment; in the example, $10 million.

**VALUE THE ADVERTISING:** The final step in the approach is simple: subtract the cost of spending on the segment-to-segment from the incremental contribution. The value of advertising the style-performance-sportiness message to the chosen segment is, thus, $2.5 million. In a real-life context, this calculation can be repeated for each segment-message combination to identify where advertising expenditure will attract the most profitable returns.




If all this seems complex and difficult, it is. Successful adoption of the approach requires substantial organisational change including improvements in analytical skills, the upgrading of customer information databases, and modifications in the planning and monitoring process. All the same, it is overdue. For too long, advertising has escaped the scrutiny directed at other areas of expenditure and investment within companies, such as new plant and equipment.

Given all the benefits that this new approach brings, the fact that it is not widely employed even in the best of companies is an indication of the barriers to change in the advertising arena. However, technology and the desire for greater efficiency will drive marketers inexorably towards more targeted advertising. The very complexity of introducing the necessary mechanisms could act as a source of competitive advantage. Those who follow the new discipline should not only reap better returns on their investment, but also build their information capabilities and improve their understanding of their customers.

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