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What If?

Link non-financial and financial measures through simulation modeling to assess ROI.

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Since marketing plays a key role in strategic planning and business operations, it is a fundamental determinant of business success. Consequently, over the past few years, the concept of marketing effectiveness has attracted increased attention among academic researchers and business practitioners. In multiple studies, experts have found that marketing effectiveness differentiates superior organizations from their competitors.

According to strategic marketer Philip Kotler, the marketing effectiveness of a firm is reflected in the degree to which it exhibits five major attributes of a marketing orientation: (1)customer philosophy, (2) integrated marketing organization, (3) adequate marketing information,(4) strategic orientation, and (5) operational efficiency.

Customer philosophy refers to studying the market, recognizing the numerous opportunities, selecting the most appropriate segments of the market to operate in, and attempting to offer superior value to meet the selected customers' needs and wants. Marketing effectiveness calls for a high level of marketing integration whereby marketing management works well with other management in manufacturing, purchasing, physical distribution, finance, and so forth. Marketing effectiveness requires managers to have sufficient information for the purposes of planning and for effective resource allocation to varying markets, products, and territories. It is also

contingent on the adeptness of managers to deliver profitable strategies from a company's philosophy, organization, and information resources. Ultimately, marketing effectiveness depends on the ability to implement marketing plans successfully at various levels of the organization.

Research and Simulation Modeling

Leading firms are combining research with simulation modeling as a means of addressing Kotler's five criteria and improving marketing effectiveness. Specifically, the growing application of this two-fold approach can be seen around the goal of building customer loyalty. Loyalty manifests in customer behaviors that have economic consequences for the firm, such as buying the brand, repurchasing, expanding the volume and scope of purchases, sole sourcing, recommending the brand, and complying with brand requests. A customer loyalty index (CLI) measures the tendency to engage in these behaviors and serves as a key indicator of marketing effectiveness. The issue is how to optimally allocate marketing (and other functional resources) to initiatives that will increase loyalty and, as a consequence, lead to superior marketplace and financial performance.

The allocation of resources should be based on facts and your strategic plan. Companies pursuing a customer-focused strategy need solid facts on how to "move the needle" on customer loyalty. This understanding comes through the execution of causal research that lays out a chain of effects, from customers' touchpoint experiences to their loyalty. Companies also need facts that relate the movement in customer loyalty to financial measures such as revenue (or revenue growth) and profitability. For example, Whirlpool Corporation, a leading manufacturer and marketer of major home appliances, has determined that a one-point movement in its CLI can have up to a 5% potential increase in revenue.

Armed with facts that tie to their strategic plans, leading firms are relying more on simulators to help make effective resource allocation decisions. Simulation modeling is a proven methodology for representing and making accessible the results of complex analysis and research. One class of these models is based on Dynamic Systems Theory created in the 1950s at the Massachusetts Institute of Technology.

Simulations can provide an integrated performance management structure that—

- Incorporates research information regarding the levels and drivers of customer loyalty

- Contains cause-effect links that tie changes in process measures to changes in customer loyalty and financial results

- Gives managers insight regarding the key drivers of future performance

- Allows managers to play "what if" games and to evaluate the impact of alternative investment scenarios

- Projects the value of performance metrics (like the CLI and its economic correlates) into the future under different loyalty-management assumptions

Loyalty simulators are built on the linkage logic that a company's investments in customer relationships influence the kinds of touchpoint and communications experiences that customers have. These experiences, in turn, shape customer loyalty. When given the opportunity to behave, loyal customers are more likely to act in ways that benefit the brand, such as making repeat purchases, buying additional products, and giving referrals. These behaviors help the company build market share, which can positively affect top-line revenue and profitability.

Most simulators provide a graphical interface that allows managers and others to propose various strategies for improving loyalty that are specified in terms of the touch-points likely to be influenced, the delay between implementation and full impact, and the annual cost incurred.

For example, a manager could evaluate the potential impact of investing in four different initiatives, such as adding to the sales force, training the sales force in business management skills, increasing the communications budget, or investing in CRM technology. For each initiative, the simulator would calculate the future values (across a planning horizon) for all the performance variables ranging from the touchpoint ratings, to loyalty, to financial impact. Depending on the sophistication, the simulator might also assess the ROI of the investments and perhaps compute their EVA or SVA.

Loyalty Simulator Advantages

The advantages of developing and using loyalty simulators for improved marketing effectiveness are far reaching. Many of these directly relate to Kotler's criteria.

Customer philosophy. Loyalty simulators are often set up by segment, taking into account the size/value and expected growth of each segment, as well as the segment's unique loyalty drivers. This allows the marketing manager to make differential investments in the segments and to evaluate the advantages of targeted approaches.

Integrated marketing organization. Simulators are excellent educational tools for improving the organization's understanding of the underlying customer/market drivers of business results. They can also be used to set performance targets on key indicators across customer touchpoints and markets that are the responsibility of different organizational units, targets that are consistent, defensible, and aligned with organizational goals.

Adequate marketing information. Simulators can increase the return on research dollars by enabling wider dissemination of the research information (i.e., more people have an opportunity to experience the data), by offering more applications for the research information (i.e., ability to screen various investment scenarios), and by providing richer understanding of the research information (i.e., better intuitive sense of what the data are saying).

Strategic orientation. Simulators allow managers to organize their observations and beliefs about the industry and think through the implications of various business initiatives from a systems perspective. Simulators help executives to think strategically about their business by forcing a systematic understanding of the relationships within the system. Also, the long-term impact of critical decisions can be studied within a simulation model immediately. When used properly, corporate planning models of this kind can change the "language" of decision-making.

Operational efficiency. Simulators provide a framework for examining the desirability of system modifications that are more tactical in nature. These could include cost reduction opportunities, customer retention programs, or changes in product availability. And, because these scenarios are simulated, they can be studied with less risk and at a lower cost than trying the same thing in the real world.

Marketing and Business Performance

Experts have found that marketing effectiveness differentiates superior organizations from their competitors. Research shows that marketing effectiveness is positively associated with business performance. For managers to assess and demonstrate the impact of investments in marketing, they need accurate measurement tools and systems that link non-financial measures such as customer loyalty to financial measures. Simulation modeling built on causal research provides an outstanding tool for making critical resource allocation decisions and improving marketing effectiveness.

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