Originally printed in MarketingNPV Journal *vol. 5, issue 2, pages 3-7*

Marketing Budgets: New Planning Cycle, Same Old Insanity

How 7 Emerging Practices Can Breathe Life into an Antiquated Process

Question: How do you get a 2% increase in your marketing budget?

Answer: Ask for 10%, be willing to settle for 5%, and you'll surely wind up with 2%.

For all the hype about social media, ROI, and putting the consumer in control, marketing is still, in this one major dimension, stuck in the dark ages. Despite the ready availability of better tools and processes, most companies are determining their marketing budgets in much the same way as they have for the last 20, 30, or 40 years.

As vital as analytical tools may be to smarter budgeting, problems from the last century persist in this one. All too often, cultural, structural, and political considerations block the promises of opportunity optimization, risk modeling, and scenario simulation. Longer-term perspectives are stymied by short-term pressures, limited vision, in-house politics, investor expectations, and knee-jerk risk avoidance.

To better understand marketers' current practices for budget setting and strategic allocation of resources, we conducted a comprehensive survey of literature and research. To that end, we reviewed the findings of a number of leading institutions and publications, including the Marketing Science Institute, the *Journal of Marketing*, the Marketing Leadership Council, the *Harvard Business Review*, the Institute for the Study of Business Markets, the American Marketing Association, the Association of National Advertisers, the Business Marketing Association, the Wharton School of the University of Pennsylvania, *AdMap*, and the World Advertising Research Center.

Moreover, we spoke in-depth with more than 50 senior marketing executives from a range of industries including consumer goods, services, B2B industrials, pharmaceuticals, and technology.

We walked away convinced that outdated methods of budget-setting are still the dominant approaches. More specifically, we learned that:

- Few companies allocate a full mix of marketing resources with high confidence in outcomes.
- Six Sigma, marketing-mix modeling, and decision support systems are having an impact on some marketing organizations. Yet those organizations that have tried to introduce new practices often have discovered that the analytical methods are not well received organizationally.
- As budget-allocation challenges have become more complex (more segments, more tactics, more initiatives, etc.), the process of making necessary assumptions is not sufficiently transparent outside the marketing department, casting doubt on the credibility of financial models and projections.

“*We walked away convinced that outdated methods of budget-setting are still the dominant approaches.*”

- In the face of budget resistance, managers most often revert to historical norms, with competitive benchmarking or percentage-of-sales increases as the primary rationalization tools.

continued>>>

Copyright © 2008 MarketingNPV LLC

continued from page 3

- Budget cuts (or, for that matter, increases) that take place without a clearly understood framework reinforce the perception that political influence is more important than objective criteria.
- Executive mobility and turnover exacerbate the marketing budget-allocation process, as assumptions and hypotheses aren't methodically validated over time.

The 3 i's of Marketing Budgeting

There are three broad-stroke characteristics that we find pervasive in the processes by which marketing departments determine their budgets. They're **insular** in that they're driven by dominant internal forces, even though they are nominally outward-looking. They're **idiosyncratic** largely because they frequently change at the whim of a single person whose calculus is in constant flux or because executive turnover mandates frequent build-it-all-over-again reviews. And they're often **insane** because managers do the same thing year after year but expect fresh new results.

While marketing budget levels and allocations should, in fact, be based upon a complex interaction of experiential, organizational, and environmental factors, the simple truth is that the process remains highly politicized and reflects more the decision style of the approving manager than the realities of the marketplace.

By far, the most common approach remains basing proposed budgets on historical spend levels. In close second is the "percent-of-sales" rationale, followed by the "match-the-competitors" logic. Relatively few organizations are basing their budgets on the expected cost of achieving targeted objectives for the upcoming year (zero-based). And only a small percentage are using any kind of robust analytical assessment to arrive at risk-adjusted budgets associated with probabilities-of-success factors.

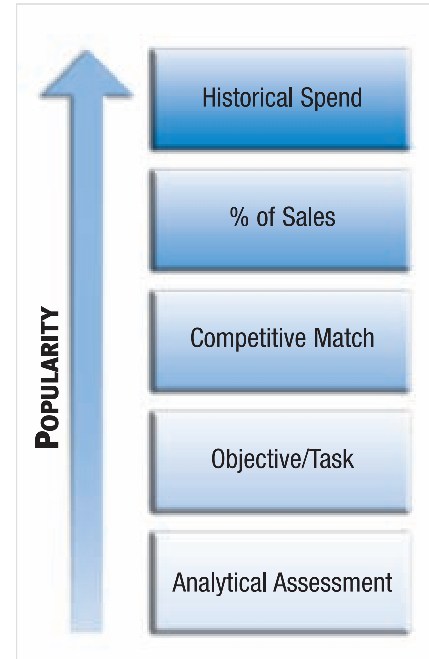
Smarter, More Credible Marketing Budgets

In most corporate budgeting processes, marketing is a passive player. Someone—usually someone in finance with no connection to marketing—gets the assignment of coming up with the first pass at an overall marketing budget. "How much do we give marketing to spend?" is the question. "How much did they spend last year?" is the answer that immediately frames a bad outcome in which marketing reacts to this stake-in-the-ground history.

Instead, marketing should *drive* the forecast. In this instance, a completely new set of questions become the process drivers:

- What if we spent this much money on marketing in this sort of way?
- What can we expect will happen to our business drivers?
- How will our investment in marketing affect attitudes and behavior in the marketplace?
- What levels of spending therefore make the most sense given our company goals?

In our research, we did see some best-in-class marketing programs where the budget-allocation process was driven by market considerations



and not internal politics. At GE, a highly decentralized bottom-up model reinforces an objective/task focus, with a relentless emphasis on estimating the ROI of a proposed initiative relative to alternatives.

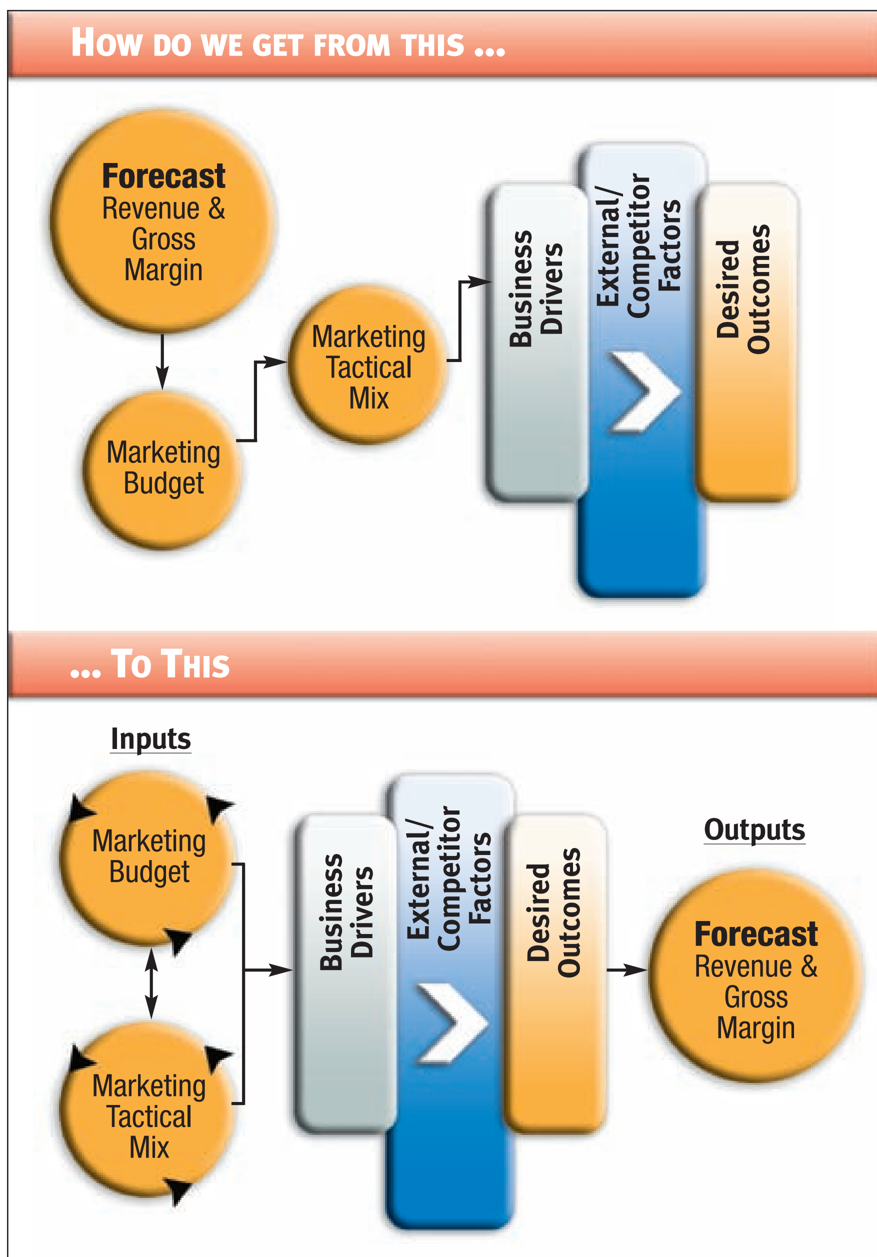
Vanguard Investments similarly brings an objective/task orientation to planning its marketing budgets. It starts with specific initiatives from the bottom up and uses insights from experiments to fill in gaps. Each product line has a unique and contextually-relevant allocation process that then filters up to senior management, where it's evaluated in a portfolio-management context.

Diageo, the world's largest multinational beer, wine and spirits company, has a budgeting challenge that's complicated by the need to support a variety of brands in markets all over the world. Marketing goals are tightly tied to a series of financial-performance

Copyright © 2008 MarketingNPV LLC

Originally printed in MarketingNPV Journal *vol. 5, issue 2, pages 3-7*

indexes. And while experience suggests that a 15-18 percent revenue reinvestment rate is what it takes for the company to maintain steady growth, Diageo's final determinations are grounded in each brand's historic response rates and competitive dynamics models. Portfolio analyses further gives Diageo brand managers an understanding of which tactical mixes are likely to work best in which markets to gain the requisite levels of consumer traction.



7 Emerging Best Budget-Allocation Practices

GE, Vanguard, and Diageo all demonstrate components of budget processes that break away from the "same-time-next-year" trap. From our conversations with these three and other smart marketers, we've identified a series of seven emerging best practices that can set marketers on a more productive budgeting path:

1. Stay Focused on Marketplace Outcomes Getting to an internal agreement on the budget is not the proper goal. Winning in the marketplace is. Construct all your arguments in market-based fact/data form and relate all spending to your best guess at marketplace impact. At GE, says Dan Henson, the former CMO who was recently promoted to president/CEO of GE Capital Solutions, "marketing's primary charter is to help deliver our organic growth goals: to grow at two to three times GDP of whatever economy we're playing in." With concurrence on the marketplace outcome from the get-go, Henson adds, "Our activities are the fuel that helps us achieve those goals."

2. Create an Analytic Framework For many marketing organizations, this is all about removing as much emotion from the process as possible. Begin by making your assumptions explicit and identifying what is known, unknown, and unknowable. Use the numbers to take your personal risk profile out of the equation. Too often marketers lose their budgeting edge by angling right from the start for less downside risk (fearing possible headcount reductions or killing pet projects) and not pushing hard for the upside opportunity.

continued>>>

Copyright © 2008 MarketingNPV LLC

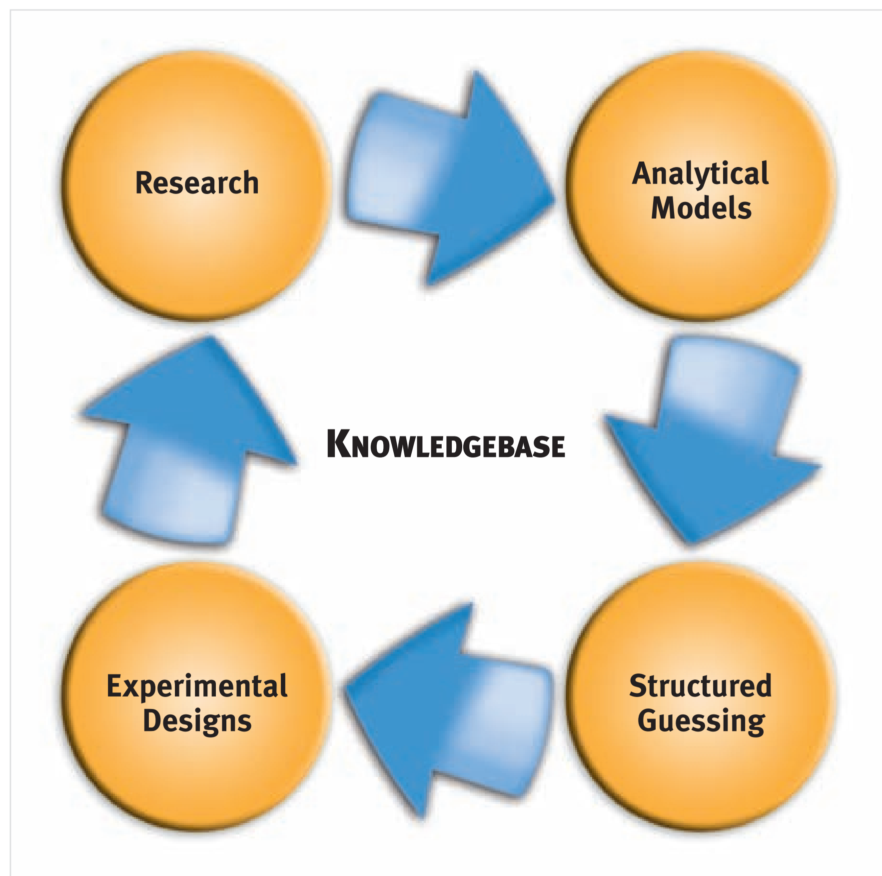
continued from page 5

They're *relieved* to get something—*anything*—in the form of an increase because they're *terrified* of losing (which they equate with a loss of power or influence — either internally or within their peer circle). By retreating into this posture, they undermine the credibility of their requests.

At Diageo, the analytical framework is an integral part of the budgeting process and it begins "once we determine the overall financial goals for the company in terms of the top- and bottom-line growth, return on investment, and cash flow," says CMO Rob Malcolm. "We have a terrific consumer planning and research group, and they are partnered with our brands in both developing the brand strategies and developing the best practice measures. They do two things: They work on what the best methodologies are, then once we determine the best methodologies and practices for measurement, they're responsible for rolling those out worldwide and ensuring the quality of those measures are adhered to and practiced in every geography."

3. Use Simulation (or Variable Weighting) Instead of Point-Estimates Budgeting is a fluid process. Opportunities (and risks) are everywhere. The more variables you can account for, the more you'll understand the full impact of your marketing dollars (and promote credibility with finance). Before you commit to a specific figure, ask some questions. How fast can a market grow? What might cause it to grow faster or slower? What will trial rates be? How can we understand which potential risks would really impact our ability to deliver the promised results? The lesson is simple: There never is one answer in any budget process. Budget development, in fact, demands a series of overlapping risk and opportunity assessments, driven by a number of simulations that cover the fullest range of outcomes.

4. Anticipate the Competitive Response How will your actions be met by competitive reactions? How will those reactions impact your ability to produce results? What if the competitors respond differently? Understanding how you expect to use your marketing resources to create and defend competitive advantage are critically important in building your case for getting them in the first place. Vanguard CMO Sean Hagerty explains the importance of building the right kind of marketing mechanism in a hotly competitive marketplace. "Marketing is moving from an expense that has to be managed to an investment in the future," he says. "We're now saying, 'How can marketing give us competitive advantage?' 'How can we invest in it appropriately and thoughtfully to gain competitive advantage? And if it can't do that for us, then we shouldn't spend.' That's a different mindset than, 'Let's manage that expense.' "



Copyright © 2008 MarketingNPV LLC

Originally printed in MarketingNPV Journal *vol. 5, issue 2, pages 3-7*

At Diageo, Malcolm adds, "We have aspirations to be one of the top consumer goods companies. We measure ourselves against a peer group of 17 other consumer goods companies. Our goal is to be consistently performing in the top third of those 17 companies. You work backwards from that and say 'What does history tell you the growth needs to be in order to consistently be in the top third?' — and that begins to frame the overall goals of the company."

5. Harvest Brand or Customer Equity Once in a While
Marketing managers are renowned for throwing out the need to "build the brand" or to "create customer value" (often in the same PowerPoint slide). Most of the time, this kind of appeal is right on target. But understanding *why* you put water in those buckets in the first place helps clarify when the time is right to draw from them. So if the company needs a few extra points of margin, marketing should understand just how much it can make the brand work to support higher prices. And if the company needs an occasional lift in sales, marketing should have a plan to surgically target segments of opportunity within the customer base. Credibility arises from not just creating assets, but from converting them into cash flow when the time is right.

6. Triangulate on Budgets Using Different Methods There is never one "right" budget process. By triangulating on a number using several different approaches, marketing managers can identify a range of outcomes and construct a model that reflects the programs' strongest features while identifying and mitigating the key risks. Seeing the world through different lenses can help illuminate uncertainties while allowing managers to focus their objectives.

7. Budget New Products/Major Projects Separately It's often beneficial to run major projects or new products on a separate and distinct budget with their own set of goals and metrics. GE is a major sponsor of the Olympics and, as Henson explains, embracing such a major marketing undertaking means putting some new rules in place. "For 131 years, this company has delivered growth through our P&L silos. What we've had to learn in Beijing is how to present one face of General Electric, because the person in charge of the National Stadium doesn't want to deal with a GE Healthcare person, a GE Lighting person, a GE Water person, a GE Electrical person, a GE Security person. So we have used the Olympics as a pilot and a template to build a seamless 'One GE' offering, particularly around these large infrastructure projects." Such monster initiatives (or the extra-ordinary circumstances of new launches) require new frameworks for assessment, and culling them out lifts the fog of "business as usual" to enable more critical analysis and creative thinking.

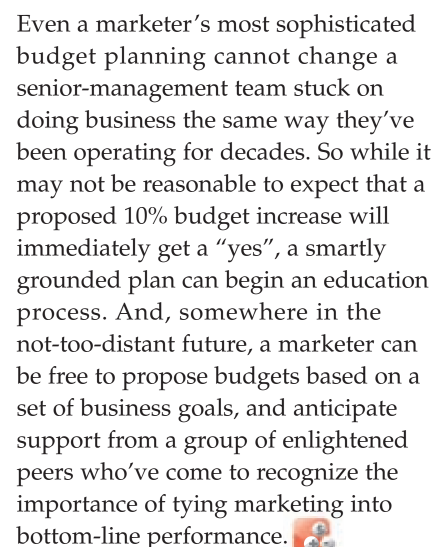
Anticipate Next Year's Budget Process Now

Our research kept pointing us to one overriding conclusion: If marketers don't work a year or more ahead of their expected information needs, they have zero probability of changing their organization's budget and allocations process. Every budget season, every CMO is presented with a number of critical questions about their assumptions. And the senior marketing people have a responsibility to build into each year's plan an appropriate set of research, tests, and analyses seeking answers. Absent a deliberate and methodical effort, these questions will plague the process year after year and drain resources from pursuit of new opportunities or blind it to subtly emerging risks.

Marketers should regularly revisit a step-by-step checklist that will help them plan future budgets. That list should include:

- Determine what will we need to know.
- Map out known vs. unknown elements.
- Prioritize unknowns on the basis of expected value vs. cost of getting the answer.
- Develop action plans to fill priority knowledge gaps over time while proxying for them in the interim.
- Start setting/managing expectations on what will be known, assumed, and guessed.

Even a marketer's most sophisticated budget planning cannot change a senior-management team stuck on doing business the same way they've been operating for decades. So while it may not be reasonable to expect that a proposed 10% budget increase will immediately get a "yes", a smartly grounded plan can begin an education process. And, somewhere in the not-too-distant future, a marketer can be free to propose budgets based on a set of business goals, and anticipate support from a group of enlightened peers who've come to recognize the importance of tying marketing into bottom-line performance.



Copyright © 2008 MarketingNPV LLC