Advertising's greatest hits: profitability and brand value

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Introduction

There are many theories about how advertising works – from immediate 'new news' call-to-action-type advertising to the more subliminal 'low involvement processing' approach. We think the one certainty about how advertising works is that there is no single process. Even for an individual, different situations will allow advertising to work in different ways. All the theories out there have some merit and will undoubtedly be true in some situations.

At Data2Decisions (D2D) we can measure what happens at the sharp end – how people respond to advertising in terms of their purchasing behaviour. Data availability and quality have improved many-fold over the last decade allowing us to become more accurate in our measurement of the payback from advertising, irrespective of how the consumer was persuaded.

Our own experiences, together with other published work, have meant that we can now look for patterns across brands, categories and countries to understand what really affects advertising profitability. Furthermore, we can rank order them which leaves us with highly actionable information. Knowing which factors have the biggest impact on advertising profitability gives us a steer on where to channel our marketing energies.

This paper discusses the learning we have at D2D from over 30 years' combined experience of modelling advertising – distilled into a top ten advertising profitability chart. Although the chart is based on short-term effects the importance of the long-term impact of advertising will be clear: as many practitioners have shown, in measuring the short-term alone we will often conclude that advertising is not profitable. Long-term effects are often considered as impacting brand value – an area of increasing importance since the 1990s.

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We will start by discussing the top ten factors that have the biggest impact on advertising profitability in the short-term and then move on to discuss which and how these can affect longer term brand value.

1. Market size

Straight in at number one is market size[1]. This often comes as a surprise to advertisers but shouldn't. A food retailer in a market worth £59 billion per year in the UK is going to find it a lot easier to generate profit from advertising than a small fmcg brand in a market worth only £0.5 billion. Market sizes can vary by a factor of 7,000 in the UK so unless advertising in the biggest market is 7,000 times less effective than the smallest market then there has to be a market-size effect.

Our calculations suggest that for an average ad to generate a short-term profit for an average brand, the market has to be worth around £2bn per year. Below this and other factors will need to be in the advertiser's favour to make a profit in the short-term.

Given the range of market sizes in the UK (and typically in other countries too) we believe market size can easily affect profitability by a factor of 16, putting it at number one in our chart by some way.

Unfortunately market size is something the marketing manager can do little about, however it is vital to understand in order to set realistic expectations about short-term advertising profitability.

One last point: the majority of advertising modelling over the last two decades has taken place in small fmcg markets[2] – mainly because data availability is excellent – leading to the biased opinion that very little advertising is profitable in the short-term.

2. Creative execution

Number two in the chart is creative execution – in other words the effectiveness of the ad used. Unlike market size this is something the marketing manager has some control over.

Many readers will know of Millward Brown's Awareness Index – a measure of how effective individual executions are at generating awareness that the brand has been advertised. This is useful because comparative data is available across many countries with typical average AI figures around 4 to 6. However, individual ads in the 20s are not unusual and figures as low as 1 equally achievable; hence an effectiveness range of 20 from best to worst.

Millward Brown has demonstrated a strong link between AI and sales effectiveness[3] so we might argue that this range applies to profitability also. We routinely model individual executions as part of

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econometric exercises and can confirm that a factor of 20 between best and worse executions is not unknown. But this is an extreme and we feel a factor of 10 is more realistic, putting creative execution firmly at second position in our chart.

The key point is that for such an important factor in profitability it sometimes gets relatively little attention. The value of pre-testing at all stages cannot be underestimated given the possible impact this can achieve. And a readiness to re-use previous high-performing ads if a new ad performs badly would be a key strength of any marketing manager.

3. Budget setting and allocation

By this we mean the level of the media budget and the allocation across media channels, brands within a portfolio and, if relevant, across countries.

Budget allocation is an area where D2D has worked for numerous clients in the UK and internationally. Our experience suggests that pushing budgets towards the most profitable brands or to the most profitable ad copy or to the countries with cheapest media costs can increase overall profitability by a factor of five.

However there are often strategic reasons why the optimum allocation isn't always palatable, so it is more realistic to expect budget allocation to produce a viable increase in profitability of around a factor of two.

4. Variable media costs

In our experience, careful laydown to avoid diminishing returns could increase profitability by around 10% (see chart entry 5). Careful laydown to maximise the opportunity of seasonal media costs can, however, improve profitability by 60% to 70%. By concentrating media into the cheapest months (which can cost 30% to 40% less than the most expensive) it is possible to generate 10% to 15% more GRPs for the same budget. Although this means blank advertising periods during the expensive months, the carried over effect typical of advertising can cover these periods – especially if the advertising in cheaper months is end-weighted to build up adstocks. And there are more GRPs available to create a higher average adstock level over the year.

Of course, care must be taken with timing of seasonal highs (i.e. it might not be ideal to be off-air if a seasonal high coincides with an expensive month) but in some cases even the seasonal impact is not big enough to pull GRPs away from considerably cheaper months.

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5(=). Laydown (phasing)

At number 5 comes another aspect of phasing: increasing profit via lower levels of diminishing returns or saturation.

This type of optimisation has become popular with media agencies over the last few years and the general opinion is that diminishing returns is a real issue for heavier advertisers (or any advertiser with exceptional creative), the solution being a continuous presence to avoid saturation, as opposed to a burst strategy.

Our experience here is that profits can rise by around 10%. Though small in comparison to the top four, 10% more on a budget of, say, £5m is not to be sniffed at, and is worth chasing once the execution and budgets have been set.

5(=). Media multiplier

Joint fifth with laydown is media multiplier. By media multiplier we mean one of three things:

i) Using more than one media to reach different parts of the audience.

ii) Using a secondary, cheaper media (such as radio) to extend the life of a TV campaign.

iii) The phenomena by which being in several media channels at once can create a bigger impact (profit) than we might expect by adding together the individual contributions of each channel.

In this third area there has been a proliferation of case studies (typically promoted by the non-TV media owners/industry bodies) and although the claimed range of additional effects can reach as high as +50% we typically observe factors of around 1.1 (+10%).

7. Brand life cycle

Analysis of many econometric studies[4] suggests that newer brands tend to generate on average slightly more profit from advertising – simply because they are newer brands and therefore are more interesting, have more scope for trial, find it easier to change image, and so on.

Modelling new brands year-on-year can often shows a decline in responsiveness to advertising as people gradually form an opinion about the new brand. For this reason it can be difficult to isolate the impact of brand life cycle but the cases we have seen suggest an 8% impact over established brands would not be unrealistic.

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8(=). Quality viewing

Eighth is quality viewing (nowadays known as break ecology) – the idea that advertising effectiveness depends on the location of the ad within the ad break (or publication) and/or the programmes it falls between. This is perhaps one of the most researched areas with many agencies trying to gain an edge over competitors by running bespoke research on different aspects of break ecology.

Typically these studies look at intermediate variables rather than sales. More importantly there is typically a cost involved with buying specific (better) spots so any improvement in sales is partly counterbalanced by increased cost.

In our experience, quality viewing campaigns have resulted in an improvement of, on average around 5% profit (i.e. taking into account the increased cost).

8(=). Task

Also with an estimated 5% improvement in profit, and so in joint eighth place, is task. By this we mean the advertising task – and more specifically whether the ad is describing a launch, a promotion or is simply brand-building.

This is difficult to measure on an individual brand basis, as creative executions are by definition different, but across a range of ads we have seen that launches and promotional ads outperform brand-building ads in the short-term by about 5%.

The important part of that last statement is ‘in the short-term’, because we also find that brand building ads tend to have longer lives, usually enough to result in a greater overall contribution to profit. This is discussed further below.

10. Audience

At number ten in out chart we have audience. Research presented at the 1995 Media Research Group Conference[5] showed that children were much better at recalling advertising, being nearly twice as likely to remember which brand was advertised compared to 16-34 year olds, and over three times as likely to remember which brand was advertised compared to 35+ year olds. Similarly users are nearly 60% more likely to remember their brand than non-users; and differences were reported in terms of sex and class.

Our experience suggests that audiences can affect profit by around 4%. The true effect depends on the specific audiences and how different they might be, but there is a limit to what marketing

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managers can do – it is obviously pointless advertising to kids just because they are more responsive if the product is not relevant.

However there may be situations where there is a choice between different target audiences (e.g. all adults or just one of the sexes) and in these cases, knowing the relative responsiveness can be of value.

The table below presents what are, in our opinion, the top ten factors affecting short-term profitability, together with an estimate of their likely impact upon profits.

Position	Factor	Profit multiplier
1	Market size	16.00
2	Creative execution	10.00
3	Budget setting and allocation	2.00
4	Variable media costs	1.60
5=	Laydown	1.10
5=	Media multiplier	1.10
7	Brand lifecycle	1.08
8=	Quality viewing	1.05
8=	Task	1.05
10	Audience	1.04

Source: Various; D2D Limited

Profitability and brand value

We believe that appropriate focus on the above factors can help increase the short-term profitability of advertising. On its own a change of creative, budget allocation or phasing could be enough to turn an unprofitable campaign into a profitable one. The true value of advertising is only apparent, however, when we consider the long-term impact.

For the purposes of this article we continue to focus on the sharp end by defining the long-term contribution in terms of the impact on sales. At D2D we routinely model the long-term impact on sales. Our two-stage process allows the short-term and long-term to select their own time periods by estimating appropriate decay rates. This might mean that the short-term impact lasts for three to six months whereas the long-term is two or three years.

Many practitioners have investigated long-term effects and typically quantify it as a multiple of the short-term. Our experience suggests

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that the total advertising impact on sales is typically three to five times the short-term impact.

This figure is validated in the literature. For example, Millward Brown[6] suggests a range of approximately two to seven; Broadbent[7] has suggested around three and Lodish *et al*[8] measure a factor of two. Comparisons across research can be difficult because not everyone uses the same time length to define the short-term. If the short-term is defined as fewer weeks then the long-term effect will naturally be a bigger multiple. From what we have read or modelled ourselves we believe that a total return of four times the short-term is an appropriate average.

A new order

So, do we simply multiply our top ten short-term effects by four to get the total advertising effect, leaving the ranking unchanged? Although the long-term evidence is sparse we believe the answer is no – some of our top ten may attract a larger multiple and move up the chart.

It helps to consider how the long-term works. At one level advertising introduces new or lapsed users back to the brand (the short-term effect). A proportion of these may then become repeat-purchasers creating a long-term effect (in effect an increase in loyalty). The size of this proportion will depend on a number of things – in particular product quality (does it deliver on its promises?), but also price, competitor activity, and so on. Advertising may also improve the conversion from short to long-term by enhancing perceptions of product performance.

Our top ten factors increase short-term profit in different ways: by reaching more potential customers; by reducing costs; by reaching the same customers more efficiently or by changing consumer attitudes and perceptions. These mechanisms might be expected to affect the long-term impact differentially. The key point is whether average loyalty levels change – either by reaching consumers with different loyalty or by directly changing the loyalty of those reached.

Market size is a special case – it simply sets the average level of profitability that advertising should achieve, and the other nine factors that impact the final level around this. Of the remaining nine factors most simply reach the same pool of consumers more efficiently so we might not expect them to change the short to long-term multiplier. However, three stand out as potentially having an impact on loyalty.

Target audience may have a significant impact by being able to target relevant customers more accurately – in one sense avoiding

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customers for whom the product isn't relevant but also finding those who are naturally more loyal.

Media multipliers can also work via the audience but more simply by enabling the advertiser to reach more people. There is also evidence that the response to seeing an ad in more than one media is higher, but there is no evidence (yet) to suggest this improves the long-term conversion.

Thus we might see 'Audience' and 'Media Multiplier' move up the chart when the long-term impact is included.

Of all the factors, creative execution seems to hold the greatest opportunity to significantly affect long-term conversion. This is all the more important when we consider it is already number two in the chart. It can achieve this through changing people's attitudes and perceptions about the brand, making consumers more aware and convinced of the brand values[6]. This in turn leads to a higher degree of loyalty and shows the value of tracking intermediate measures as well as the sales data covered in this article.

Summary

We have focused on how advertising impacts sales and profitability, as this is the sharp end of business and avoids the need to understand the complex way in which advertising works. Our conclusion is that market size is the biggest single determinant of advertising profitability, but clearly this is not something the marketing manager can easily control. However, creative effectiveness is a clear second in our short-term list and also shows the greatest opportunity to improve the short to long-term gearing, thus having the greatest potential impact under the control of the marketing manager.

This does not mean we should ignore the other factors. Once the creative is decided they still offer great scope to improve the profitability of advertising.

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