

Opportunities for Action in Consumer Markets

To Spend or Not to Spend: A New Approach to Advertising and Promotions

THE BOSTON CONSULTING GROUP



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Trying to outshout the competition in an environment that is increasingly cluttered and costly can lead to frustration and low returns. With expenses for advertising and promotions (A&P) adding up to more than 20 percent of sales for many consumer companies—and with pressure from retailers to spend even more on promotions—managers are looking either to reduce these costs or to reap more value from them.

For A&P to be effective, companies must spend on the right brands in the right regions and convey compelling messages through the right channels. Given the confusion created by proliferating channels, many marketers are trying to understand which channels and promotion models are most efficient. That is a tremendously important but complex question that will take time to answer.

Yet even as marketers search for the answer, they can increase returns immediately and dramatically by allocating A&P expenses in a fundamentally new way. Our approach is founded on zero-based budgeting and an aggressive differentiation of investment levels by brand, market segment, region or country, and—ultimately—retailer. Companies that have applied this approach rigorously have freed up as much as 20 percent of their A&P investment. That, in turn, has allowed them to focus spending where it will have a much greater impact.

The Current State of Spending

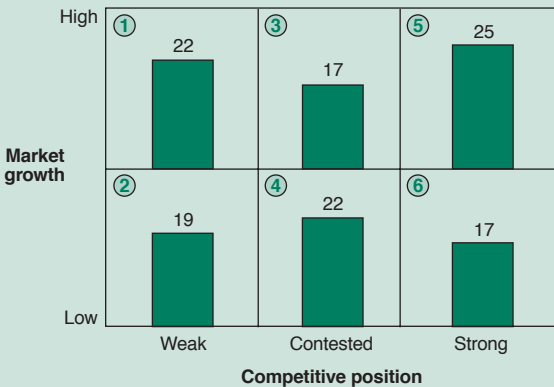
Few companies with a portfolio of brands directed at a variety of market segments in different regions or

countries adequately differentiate their investments on the basis of strategic priorities. One typical European consumer-goods manufacturer, for example, had a similar level of A&P investment (as a percentage of turnover) for each of the brands and countries in its portfolio, regardless of the brand's competitive position and the market's potential for growth. (See Exhibit 1.) As a result, the investments weren't focused on the most optimal areas.

The investments of this manufacturer in brands and countries with a weak market position (boxes 1 and 2) were relatively small and below the minimum investment level, when measured in absolute euros. This spending, therefore, had little impact. Investments in brands and countries with a highly competitive and growing market (box 3) were also limited, so the potential in these markets went unexploited. Investments in brands and countries with a low-growth

Exhibit 1. Many Companies Fail to Optimize A&P Investments Across Their Brand Portfolios

One manufacturer's distribution of A&P investments in brands and countries as a percentage of turnover



SOURCE: BCG analysis.

but highly competitive market (box 4) were insufficient to break the stalemate, yet were too high for a harvest strategy. Investments in brands and countries with a leading market position (boxes 5 and 6) were far in excess of the level required for maintenance and also had little impact, since it was no longer possible to increase market share significantly without a breakthrough innovation.

Of course, most marketers don't start out with the intention of investing at the same level in every market. The fact that so many companies end up doing so is a result of the way support budgets are developed. In most companies, managers from various areas get together annually to negotiate new budgets by translating brand strategies into incremental adjustments to the previous year's budget. Rarely do they entertain the possibility of allocating no funds, or considerably more funds, than were designated the previous year. With a zero-based budget, however, that is exactly what they would have to consider.

The traditional process suffers from three shortcomings. First, it gives only limited consideration to the significant differences in A&P intensity and sensitivity that often exist among market segments and regions or countries. Second, it fails to recognize the fundamental choices to be made among growth, maintenance, and harvest strategies for each brand, segment, and region or country. Third, market share and the impact of support investments on profits are not measured, and, as a result, share targets are not linked to A&P budgets.

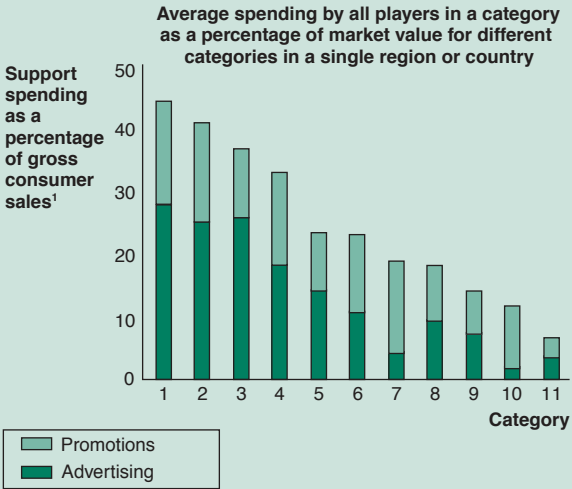
The Dynamics of Zero-Based Budgeting

To better allocate A&P investments, it is essential to begin with a zero-based budget. Our approach, which

we have used successfully in our client work, is founded on the following practical observations about the core drivers of appropriate A&P support:

- *A&P Spending Intensity.* This can differ considerably from one category to another. In our experience, the average A&P investment of all the players in a particular category (in a single region or country) can range from as little as 5 percent to as much as 45 percent, depending on the category. (See Exhibit 2.)
- *Company Market Share.* The advertising investment required to maintain market share (the *maintenance level*) is directly related to scale and competitive position. When relative market share doubles,

Exhibit 2. Market Support for All Players in a Category Varies Greatly from One Category to Another



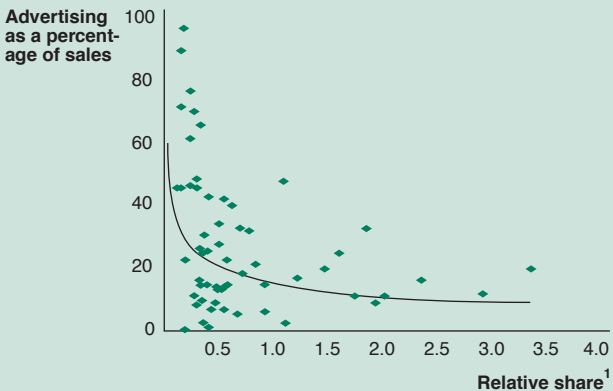
SOURCE: BCG analysis.

¹Support spending comprises advertising, promotional expenses, and discounts; gross consumer sales is the total volume times the nonpromotional price.

for example, the advertising investment (as a percentage of sales) required to maintain that share can be reduced by 30 percent. (See Exhibit 3.) Note, however, that the investment needed for promotions to maintain market share is usually *not* related to scale or competitive position. (See Exhibit 4.)

- *Threshold Investment Levels.* Investments in advertising below a minimum level are usually ineffective, so it is better not to make them at all.
- *Category Responsiveness to A&P.* The effect of investments in excess of the maintenance level on market share differs from one market segment to the next. The amount of investment required to win 1 percent of market share in a single year, for instance, can

Exhibit 3. Required Advertising Investments Correlate Strongly with Relative Share



SOURCE: BCG analysis.

¹Relative share is a player's share divided by the share of its largest competitor.

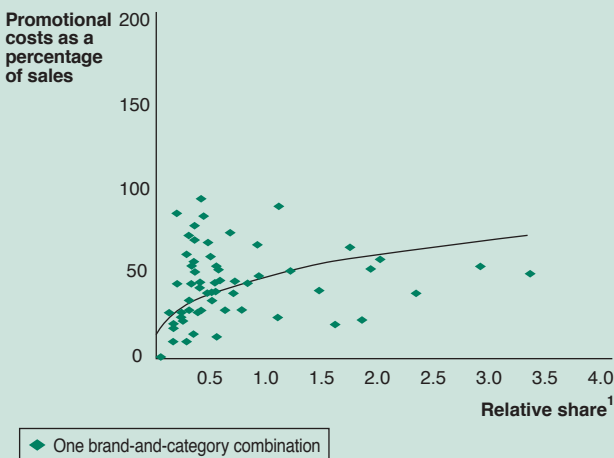
vary from two to four times the maintenance level. Furthermore, these investments will be effective only if a breakthrough innovation exists and all the other elements of the marketing mix support market-share growth. (See Exhibit 5.)

- *The Future Value of the Category.* The value of any growth in market share can vary greatly among brands, market segments, and regions or countries, depending on market growth and profitability.

Finding the Optimal Approach

With these insights in mind, we have developed a methodology for identifying the optimal A&P invest-

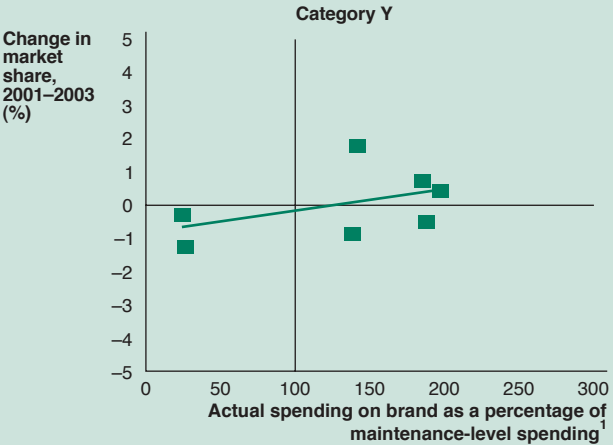
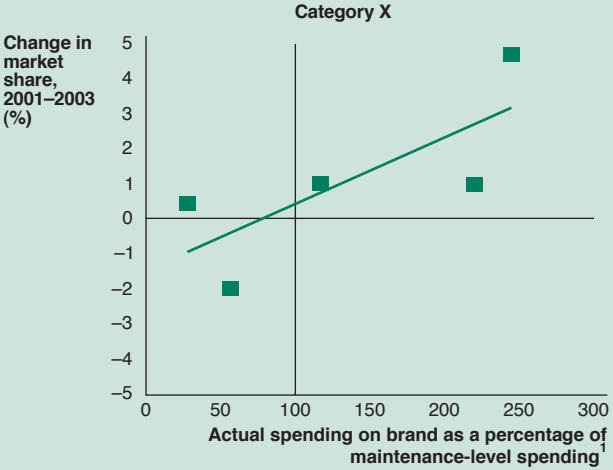
Exhibit 4. The Investment Required for Promotions to Maintain Market Share Is Usually Not Related to Scale or Competitive Position



SOURCE: BCG analysis.

¹Relative share is a player's share divided by the share of its largest competitor.

Exhibit 5. The Cost of Increasing Market Share Can Vary Greatly Across Categories



SOURCE: BCG analysis.

NOTE: Each square represents a brand. The diagonal lines represent the average correlation between support spending and the change in market share for all brands in the category. In Category X, support spending must increase 2.6 times to produce a 1 percent growth in share. In Category Y, spending must increase 4 times to produce 1 percent growth.

¹Maintenance-level spending is the average spending on all brands in a category, adjusted for the relative market share (or scale) of a brand.

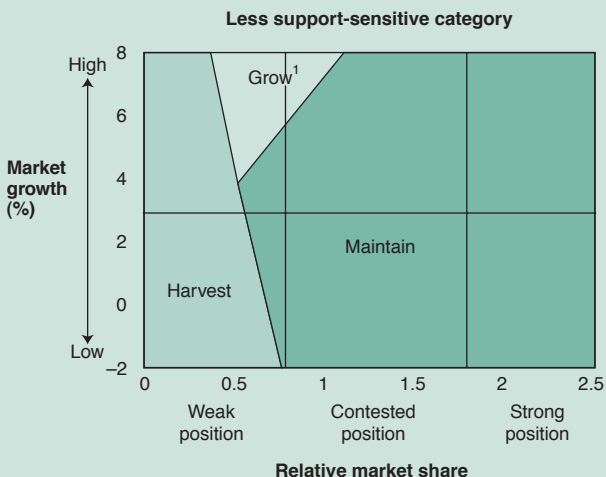
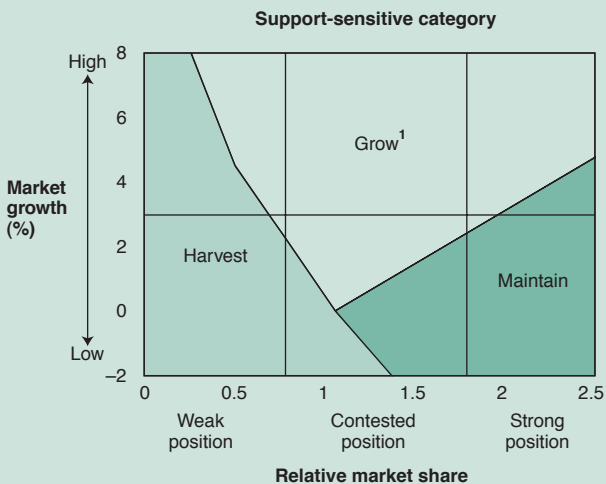
ment level for each brand in each market segment and region or country. It involves three steps.

Measuring the effectiveness of past support spending.

Assessing investments in light of the first four drivers of A&P spending described above will reveal the underperformers, whose problems then need to be diagnosed and fixed. Underperformance can stem from problems with the quality of the support spending (the wrong advertising message or media mix, ineffective scheduling, or ineffective promotions) or problems with the marketing mix (lack of innovation, wrong pricing, or a declining share of distribution). In one case, we found that a client's past investment levels for a leading brand in one country were far in excess of what was needed to maintain share. The company had introduced no significant innovations, and, not surprisingly, its investment failed to yield any growth in market share. When management realized this, it decided to cut back spending and pursue a maintenance strategy until a meaningful innovation became available.

Estimating the net present value (NPV) of a growth, maintenance, and harvest strategy for each brand and segment, taking into account expectations of future category growth and value. These calculations enable management to choose among the three strategies for each brand, segment, and region or country. (See Exhibit 6.) Of course, this choice cannot be made on the basis of NPV calculations alone. Other factors—such as the promise of the innovation pipeline, the “brand voltage,” and the role of a market segment within an umbrella brand—must also be taken into account. Nevertheless, estimating NPV for each generic strategy adds science to the art of finding the right investment level and highlights fundamental choices that might otherwise be overlooked.

Exhibit 6. Find the Optimal Level of Support for Each Brand, Segment, and Region or Country



SOURCE: BCG analysis.

¹A growth strategy makes sense only if the other elements of the marketing mix support it. If they do not, a maintenance strategy is most appropriate.

Determining the spending levels required to reach market-share targets for each strategy and the level of competitive intensity for each brand, segment, and region or country. We have found that one of the chief benefits of our methodology is that it provides clients with hard numbers to substantiate the need to reallocate investments. If, for example, a company has a strong competitive position in a market of limited or no growth, it may be more inclined to adopt a maintenance strategy—especially if the model indicates that sensitivity to A&P investment is low. Choosing such an option could reduce A&P investments by as much as half.

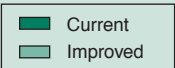
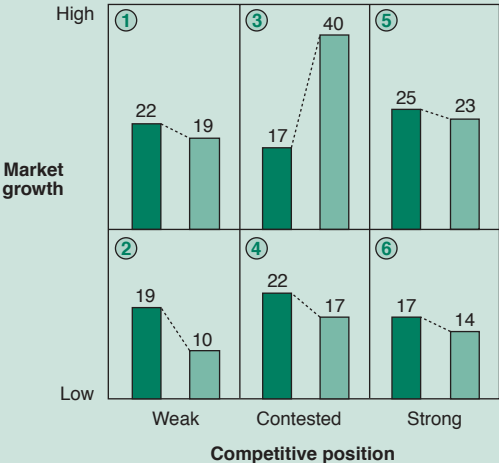
In the case of a contested—or strong—competitive position in a high-growth market, the company might consider an investment strategy *if* the appropriate conditions exist. First, there would have to be a pipeline of solid innovations, along with other elements of the marketing mix to support growth. Second, consumers in the market segment would need to be sufficiently sensitive to advertising and promotions in order for the added investments to result in increased market share. If those conditions don't exist, a maintenance strategy would be the most logical approach.

If a brand has a weak position in a high-growth market or a contested position in a low-growth market, the company would be well advised either to invest in order to gain market share or to harvest. And if the intensity of A&P is high in the relevant market segment, a harvest strategy would be preferable to investing. Of course, companies should also consider the innovation pipeline. If a breakthrough innovation can be launched, an investment strategy may be justified even if the starting position is weak. And finally, a harvest strategy is best if a brand occupies a weak position in a low-growth market.

If we were to apply our methodology to the company in Exhibit 1, it would reveal that a major reallocation of spending was in order. (See Exhibit 7.) Note, however, that this example depicts *average* spending in each quadrant. The differences would be even greater at the level of individual brands. In the case of specific brands in boxes 2 and 6, all further investment might be stopped, whereas the level of investment for a number of brands in box 3 might exceed 40 percent. Overall, application of the methodology could result in a 20 percent reduction in A&P investments (or a decrease from 20 percent to 16 percent of turnover). At the same time, the investments in high-growth market segments, or in regions or coun-

Exhibit 7. By Reallocating Spending, a Manufacturer Can Optimize Its A&P Investment

Recommended shift in A&P investment as a percentage of turnover for one manufacturer



SOURCE: BCG analysis.

tries where the company holds a contested position, would have greater impact.

Thinking Differently About Maintenance and Harvesting

Our methodology can be a good tool for supporting a more aggressive differentiation of investment levels in a portfolio of brands aimed at a variety of market segments in different regions or countries—if the organization is prepared to implement it. To be sure, implementation will require most packaged-goods companies to make some fundamental changes, such as:

- Establishing a fact-based assessment of the effectiveness of total support spending in terms of market share and profit impact
- Moving from incremental budgeting to fact-based and greenfield discussions on allocating support spending (with the explicit involvement of financial and general managers)
- Resolving the frequent discrepancies between advertising (managed by the marketing department) and promotions (managed by the sales department) so that these functions can cooperate on integrated advertising and promotional plans for each brand, category, and region or country

When combined with a comprehensive support-spending platform, our approach can be an important enabler in bringing these changes about. Mobilizing the organization to use the methodology, however, will require a new attitude toward maintenance and harvesting strategies. In many companies, managing a maintenance or harvest brand is viewed as less than beneficial to a manager's career. That is why

most brands and regions or countries are identified as growth possibilities, even when the NPV of a maintenance or harvest strategy would be much higher.

Before an organization decides to differentiate its investment levels, it must be willing to have some of its best people manage its maintenance and harvest brands, and it must assess them on that criterion specifically. The fact is that defending a market-share lead with limited resources or maximizing profit in a shrinking market with hardly any resources often requires more effort and talent than growing market share in an expanding market with nearly unlimited resources.

* * *

Most consumer companies could radically improve the effectiveness of their spending on A&P by differentiating investment levels by brand, market segment, and region or country more aggressively than they typically do. If you suspect that this may be true for your company, here are some key questions to address:

- How large are the differences in our company's A&P investments, as a percentage of sales, for each brand, market segment, and region or country?
- Is there a clearly defined strategic rationale for these differences (or for the lack of differences)? Are the differences in the intensity and sensitivity of advertising and promotions among the various market segments and countries adequately acknowledged? Are the differences in our competitive position (relative market share) properly translated into a maintenance level for the brand? Have we made a clear choice among maintenance, harvest, and growth approaches for each brand, seg-

ment, and region or country? Does this choice reflect the level of A&P investments?

- How does our company decide on its total A&P budget for each brand, segment, and region or country? Is the decision based on sound logic or does the process of negotiation result in incremental adjustments to the previous year's budget?

Considering questions such as these has led many companies to reassess their current practices, and that has opened up opportunities to reap significant additional value from the efficiency and effectiveness of their A&P investments.

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