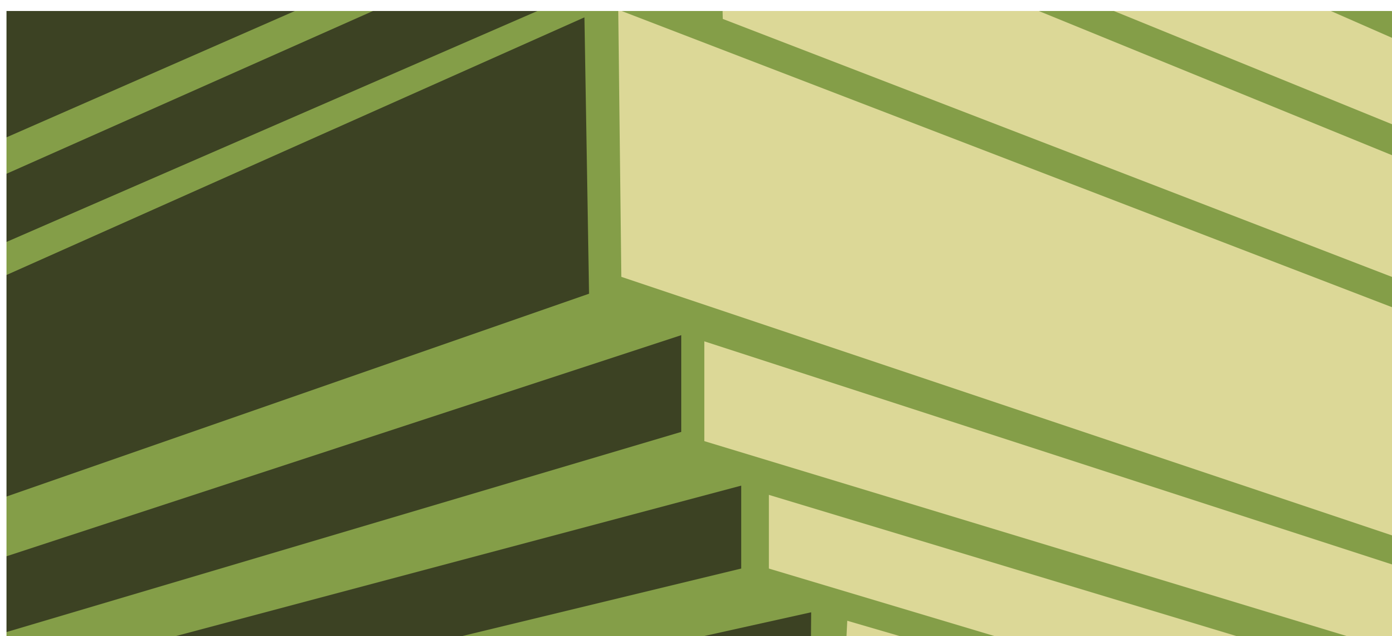
The McKinsey Quarterly

MARKETING
DECEMBER 2008

The downturn's new rules for marketers

The old recession playbook won't work this time around.

David Court



McKinsey&Company

Around the world, marketing and sales executives are being asked to do more with less. It's a demand many have heard in previous hard times, and most managers muddled through then. But the nature of the current downturn—and of the changes the marketing and sales environment has undergone since the 2001–02 recession—suggests that those who follow the survival techniques of past slowdowns risk betting on the wrong markets, customers, advertising vehicles, or sales approaches.

In previous downturns, many marketers doubled down on large, historically profitable customers, geographies, and market segments. Today, this approach may prove ineffective because the world's economic woes are affecting customers and markets in unexpected and extremely specific ways. Marketers should therefore toss out those historical expectations and focus on the emerging pockets of customer profitability.

Cash-strapped marketers have also typically emphasized traditional media, such as television and newspaper ads, while cutting back on new advertising vehicles. But marketing has evolved rapidly over the past decade, with traditional media declining in importance as the Internet and social networking achieved meaningful scale. Marketing executives trying to rationalize media spending must factor this new balance into their austerity programs.

Another common approach for marketers trying both to cut costs and safeguard revenue has been to slash back-office sales overhead while continuing to invest in frontline salespeople. The evolution of the sales force in recent years means that marketers should take a much more nuanced approach. Companies used to regard the "feet on the street" model as their primary lever for increasing sales. Now they rely on a mixed model—customer-centric frontline product specialists and industry-specific sales managers who play a coordinating role—to provide better service and target new revenue opportunities.[1] If executives ignore these new practices when they rationalize sales programs, hard-won customer relationships, revenue streams, and margin gains may be at risk.

Of course, not everything from the past is outmoded: marketers must still reexamine the value propositions of their brands, fine-tune products and pricing, and manage the cost of media agencies and other vendors carefully. But these steps aren't enough. To weather the storm, it will be necessary to identify anew who and where the profitable customers are and to prioritize the most effective marketing and sales vehicles for reaching them.

When marketing and sales executives do so, it's critical to bear something in mind: the broader forces at work in the global economy mean that the

underlying economics of strategies could continue shifting with unprecedented speed and scale. Such extreme uncertainty demands constant attention, frequent reprioritization, and strategies that anticipate and respond to a changing landscape.

Where to invest sales and marketing resources

The impact of recessions always varies across economies; for one thing, unemployment levels rise at different rates in different regions. This time around, however, global economic conditions are affecting different geographies and demographic groups in even more diverse and complex ways.

- A global credit crunch and the attendant volatility in commodities are whipsawing economies around the world in different ways at different times, which means the relative attractions and risks of customers and countries are shifting rapidly.
- The housing sector is contracting in markets around the world, but the level of mortgage default rates and the effect on consumer spending vary across and within regions. In the United States, for example, Arizona, California, Florida, Michigan, and Nevada have been hard hit, while other states less so.
- Historically attractive demographic groups have experienced major reversals of fortune. The nest eggs and retirement prospects of the baby boomers, for example, have been dramatically reduced by rapid declines in equity and housing values. This development raises the possibility of significant shifts in spending.

These disruptions suggest that the old tactic of focusing on historically profitable regions and customer groups will miss the mark. Instead, marketing and sales executives must reprioritize geographic markets and customer segments at every shift of economic fortune.

Reprioritizing geographies

Multinational companies will have to reassess their growth forecasts for the countries where they compete. Even assessments conducted as recently as 2008 should be reexamined, since the crisis has affected every country on Earth.

One global technology company, for example, recently began a major repositioning that shifted its marketing expenditures from developed countries to emerging ones offering higher projected growth rates and weaker competitive pressures. Recent economic events, though, have invalidated some

of the territory-by-territory profit assumptions and significantly changed the time horizons of expected growth for others. The company recognized that its broad-based pre-crisis repositioning effort would generate disappointing results, so it is now working to identify markets with better prospects in this tough economic environment.

Companies can protect their revenues and profit margins by taking this granular approach a step further. Even within sectors or geographies that seem down across the board, the rates at which potential customers grow or decline vary substantially. While it is well known that the US manufacturing sector, for example, has weakened considerably over the past few years, manufacturing GDP has actually expanded in many counties across the country. In fact, from 2006 to 2007 the manufacturing revenues of companies in these counties rose by $97 billion,[2] roughly two-thirds of China's manufacturing growth over the same period. In Michigan, one of the hardest-hit states in the US Midwest, growth rates vary by double-digit percentages, and manufacturing revenues in the top counties rose by nearly $2 billion in 2007. Of course, no marketing strategy could now rely on these outdated figures. But a similar analysis today, probably at an even more detailed level, would in all likelihood help a company that sells manufacturing supplies to focus its scarce sales resources on growth counties instead of deploying resources across the board in a declining market.

Consumer marketers with access to micromarket data have even more opportunities to enhance profitability. One beverage company recently conducted surveys that identified staggering differences in the potential profitability of customers within individual markets and micromarkets. The price sensitivity of the respondents varied by as much as a factor of 13 across regional markets, a factor of 5 across cities within them, and a factor of 3 across zip codes within individual cities (Exhibit 1). Armed with this level of detail, a company can maximize its profitability by focusing on micromarkets less sensitive to prices while also offering discounts or preferential pricing elsewhere to drive sales volumes.

EXHIBIT 1

Looking at micromarkets

Reprioritizing consumer segments

Much as the profitability of different regions and micromarkets has shifted, fluctuating unemployment rates, equity prices, and housing and fuel costs have changed the profitability of consumer groups that cut across geographies. In many cases, changes in consumer behavior will force companies to reallocate marketing resources from historically attractive segments. Some groups that until recently had been major contributors to spending growth will become less profitable. Affluent young professionals, many of whom work in the financial-services sector, probably won't continue to fuel historic levels of growth in luxury goods, for example.

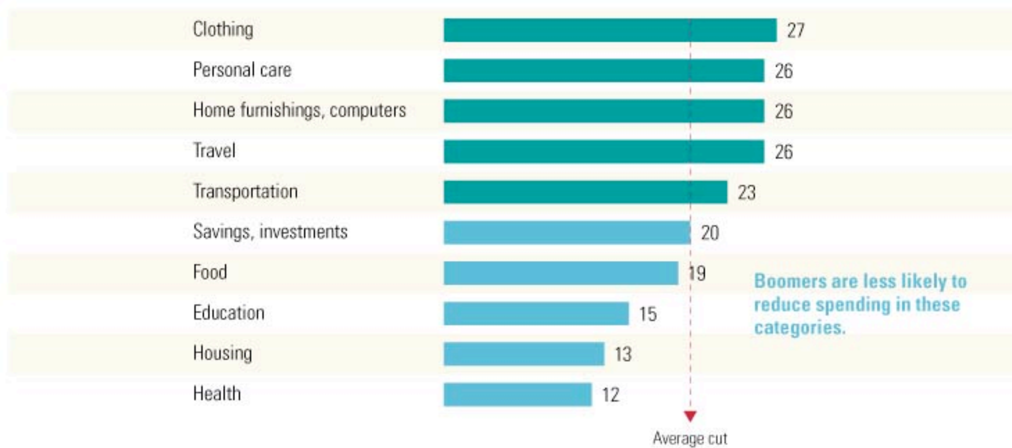
In other cases, the shock of the economic crisis could accelerate longer-term shifts in the spending and attractiveness of segments, such as the baby boom generation in the United States, as well as its counterparts in Japan and Western Europe. The high spending rates of the boomers made them a sought-after and profitable customer segment for many companies. The "wealth effect" of real-estate appreciation, along with the gains (or hopes of future gains) of the equities in the boomers' retirement accounts, enabled much

of this spending. Indeed, many boomers were borrowing against these assets to pay for their lifestyles.[3] As a result, US boomers have saved less for retirement than previous generations did.

Today, the one-two punch of depressed housing values and big losses in equities means that many boomers face uncertain retirement prospects and can't continue to spend as they once did. In fact, they will have to reprioritize their spending across categories en masse. In 2006, when we asked boomers how they would cut their overall expenditures by 20 percent, the respondents singled out clothing, personal care, home furnishings, and travel for cuts but said they were less likely to reduce spending on necessities like food, housing, and health (Exhibit 2). For companies in the sectors, such as home furnishings, that will probably bear the brunt of these spending shifts, the task ahead is to target demographic segments with better growth prospects.

EXHIBIT 2

Shifting priorities



Source: 2006 McKinsey survey of aging US consumers; McKinsey analysis

Reprioritizing business-to-business opportunities

Business-to-business (B2B) companies must go a step further. A fresh look at segments isn't enough; instead, such companies must reexamine their opportunities and risks on a customer-by-customer basis. Of course, they must start by assessing the basics: whether a customer has enough cash or liquidity and the likelihood that such funds will survive. Then they should think about how the crisis will affect all aspects of their profitability.

Many suppliers, for example, have long-standing agreements to offer volume-based rebates to their customers who are distributors. But the weak economy may cut the volumes of some distributors drastically, so that they no longer qualify. Similarly, some customers may find their economics undermined by volatility in the price of their key inputs, such as fuel and other commodities, and will therefore no longer be able to buy at the volumes and prices suppliers expect. Suppliers must stay alert to these possibilities and respond accordingly.

For a leading manufacturer of industrial controls, such shifts have drastically affected margins, transforming what a year ago was one of its most profitable accounts into one of the least profitable today (Exhibit 3). In the past, this account rated preferential attention and service, flexible terms, and high levels of tech support. Now, it calls for aggressive corrective action—reining in costs to serve, renegotiating rebates, encouraging more efficient order quantities—of a kind that would have been unthinkable not long ago.

EXHIBIT 3

The morning after

[1] Pocket margin is a precise and comprehensive measure of customer profitability that includes all on- and off-invoice discounts and all account-specific costs-to-serve (eg, special handling and packaging, tech support).

How to invest marketing and sales resources

In addition to putting resources into the geographies and customers with the greatest profit potential, executives must emphasize the media and sales

efforts most likely to deliver such profit. In previous downturns, that meant investing in proven advertising vehicles while cutting back on newer ones with shorter track records, as well as focusing resources on sales reps while trimming central back-office functions.

Over the past several years, however, the challenges of marketing proliferation have created a more complex mix of marketing vehicles and sales models.[4] Historical responses or across-the-board cuts may be exactly the wrong thing in this recession (see sidebar, "Budgeting on autopilot"). A more nuanced approach is required.

Budgeting on autopilot

Marketers aren't alone in reacting to downturns by giving budgets a standardized haircut. Another example of rule-of-thumb decision making involves cutting costs by some arbitrary fraction across all business units in multidivisional companies. (Similarly, during times of economic and industry growth, budgets often increase by an arbitrary percentage of sales or assets.) In fact, for diversified companies in the United States, the correlation of the year-to-year percentage of investments going to each business unit from 1985 to 2005 is 0.85; in other words, each business unit's share of the investment pie remained fairly constant over time. This correlation holds up during good times and bad.

Such behavior makes a certain psychological and organizational sense—it taps into our human notions of fairness, is cognitively simple, and raises few political concerns. As a practical matter, all executives are capable of making such across-the-board increases and decreases in the very short term. Thoughtful executives, however, should quickly focus on more granular growth and profitability differentials within business units in order to trim underperforming investments dramatically while simultaneously seeding promising ones for the coming spring. This is an important insight in normal conditions and an even more crucial one during these tough economic times, when widening the gap between your company and the crowd becomes urgent.

About the Author

Dan Lovallo is a professor at the University of Sydney and an adviser to McKinsey.

Reprioritizing advertising vehicles

New communications vehicles such as the Internet, social networking, and mobile devices are gaining scale and delivering effective results. Meanwhile, classic media such as television have become, at a minimum, much more costly. Most marketing plans therefore try to meet their objectives cost-effectively by using a mix of traditional and new vehicles, with the latter typically accounting for 10 to 15 percent of spending.

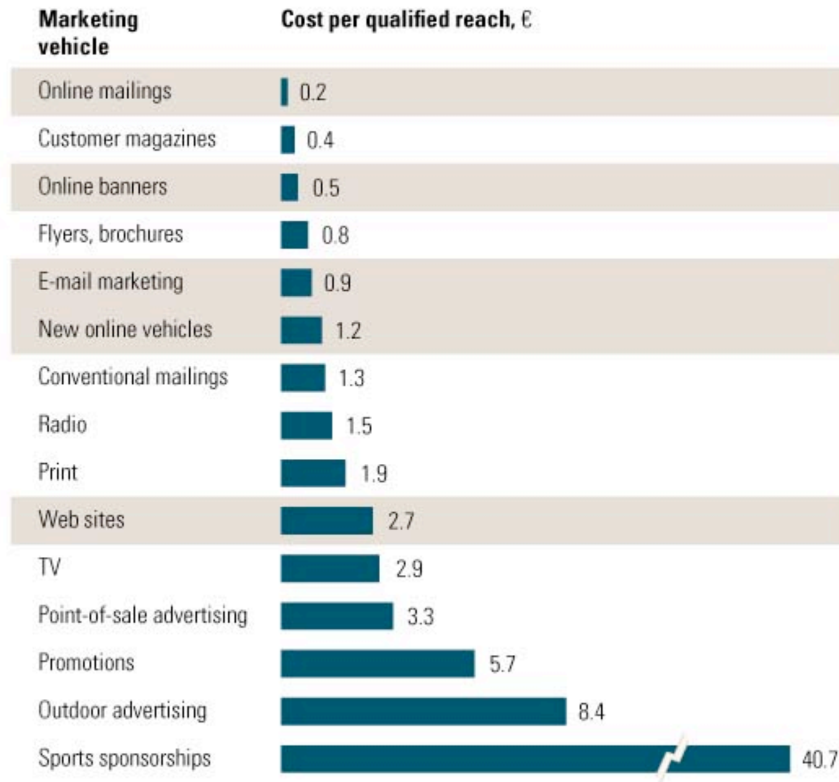
A reprioritization of this kind requires a better understanding of the effectiveness of different forms of advertising than many marketers have today. These marketers, who assume the reach and cost of a vehicle serve as a proxy for its effectiveness, ignore the vehicle's quality—that is, its ability to influence customers. Quality is easiest to measure in direct businesses, which can precisely determine the return on investments in outbound catalogs or e-mails. But there are ways to estimate the quality even of harder-to-measure vehicles—such as television, product placements, and sponsorships—and to prioritize them accordingly.

Companies can maximize the accuracy of their quality assessments by combining a variety of information sources, such as quantitative customer surveys, postevent focus groups (for sponsorships or other on-the-ground marketing efforts), and workshops where marketing managers and outside experts from advertising and media agencies piece together a collective point of view. Several major consumer companies that recently conducted such workshops found the consensus reached in them extremely consistent with more in-depth, quantitative studies.

No matter how a company arrives at its quality assessment, the real power comes from combining that analysis with data on the reach and cost of an advertising vehicle. This combination of reach, cost, and quality helps marketers compare the impact of different vehicles on an "apples to apples" basis—the key to effective prioritization. As the experience of one representative company demonstrates, it is not uncommon to find a hundredfold difference between the impact of two different vehicles (Exhibit 4). There is no consistent pattern indicating whether traditional or new vehicles have higher scores for reach, cost, or quality, so marketers must make their own objective comparisons to eliminate ineffective vehicles without hesitation and to support high-impact ones with confidence.

EXHIBIT 4

A range of effectiveness



Reprioritizing sales functions

As we have seen, in tough times companies try to improve their profits by reducing sales overheads while concentrating resources on the frontline sales force. But today's sales teams use newer kinds of support that are too important to cut indiscriminately: they play strategic roles in the sales process and are critical to serving the most profitable customers and to converting new prospects. An executive who slashes these support functions as part of a broad cost-cutting campaign risks severely damaging the sales force's effectiveness.

Consider how recent changes have played out at a large industrial-services company. Ten years ago, 90 percent of its salespeople served either in account management or in the field. Only limited support was available, in the form of sales training, product information brochures, and a few product specialists. This company significantly increased the number of product specialists because its customers demanded greater expert assistance and its product range was expanding. It also added a pricing group for contract negotiations,

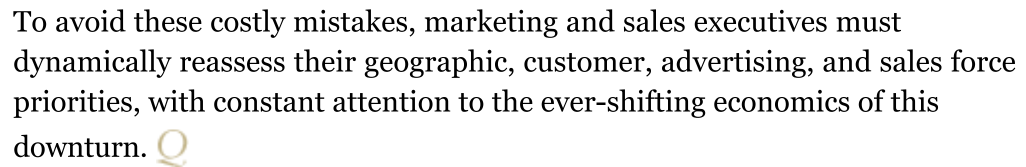
industry-specific sales managers who provide additional expertise for customers, outbound telemarketing representatives who identify opportunities to gain small and midsize customers, and a customer and competitor analysis group to help decide how aggressively the company should support new opportunities.

In today's downturn, this organization's head of sales had to trim costs by 10 percent. Eliminating some product specialists, industry-oriented managers, and telemarketing support would probably cut the number of new leads and win rates so much that sales would fall more than they would if the company eliminated an equal number of salespeople or account managers. Similarly, thinning out the pricing or competitor analysis teams might lead to poor pricing decisions that would depress margins or to the wasting of time on unrewarding sales prospects. An analysis of win rates and profit margins on new contracts helped the head of sales to confirm that the retention of product specialists and pricing specialists was crucial to maintaining profitability.

Instead of making across-the-board overhead cuts, a company can rationalize its sales programs while maintaining performance in a variety of ways. Assessing the current sales-coverage model helps the company determine which selling and sales-support formulas are most effective for which types of customers and sales situations and then to rebalance resources as needed. In practice, this approach might mean handling reorders online, covering basic sales and account-management tasks through telesales representatives, and using larger response teams to address major requests for proposals. Another important step is to analyze win–loss ratios in difficult customer negotiations with an eye to determining which sales support groups are most effective and which contribute less and can therefore be trimmed. Streamlining the after-sales process and establishing the appropriate level of customer support can shrink costs as well. Critical to all these moves is an understanding of what customers expect and of the importance of after-sales support to their overall experience.

A nuanced approach like this can help sales and marketing executives to identify cost savings more confidently and to protect the people and programs making a direct contribution to profitability.

Companies that follow the playbook from past recessions will probably chase markets and segments made less attractive by the present downturn and focus too many resources on traditional marketing vehicles and frontline salespeople.



To avoid these costly mistakes, marketing and sales executives must dynamically reassess their geographic, customer, advertising, and sales force priorities, with constant attention to the ever-shifting economics of this downturn. Q

About the Author

David Court is a director in McKinsey's Dallas office.

The author gratefully acknowledges the contributions of Thomas Baumgartner, Jonathan Gordon, Maryanne Hancock, Dieter Kiewell, Mike Marn, and Jesko Perrey.

Notes

[1] For more on collaborative selling, see Maryanne Q. Hancock, Roland H. John, and Philip J. Wojcik, "Better B2B selling," mckinseyquarterly.com, June 2005.

[2] Measured in 2000 US dollars.

[3] See David Court, Diana Farrell, and John E. Forsyth, "Serving aging baby boomers," mckinseyquarterly.com, November 2007; and Eric D. Beinhocker, Diana Farrell, and Ezra Greenberg, "Why baby boomers will need to work longer," mckinseyquarterly.com, November 2008.

[4] For more on marketing proliferation, see David Court, Thomas D. French, and Trond Riiber Knudsen, "Profiting from proliferation," mckinseyquarterly.com, June 2006.

Related Articles on mckinseyquarterly.com

"The evolving role of the CMO"

"Confronting proliferation: A conversation with four senior marketers"

"Boosting returns on marketing investment"

"Profiting from Proliferation"

Copyright © 2008 McKinsey & Company. All rights reserved.