EFFWORKS

IPA

Marketing is an investment

By Ian Whittaker

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This report was written by Ian Whittaker, a former City equities research analyst who is now the Founder and Managing Director of Liberty Sky Advisors, a consultancy that advises agencies and companies across the technology, media and telecoms space.

Additional editing by Carlos Grande, IPA Editorial Consultant.

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Foreword

Management teams know that marketing is critical to engaging customers and growing businesses. But they also feel under pressure to deliver consistently on their companies' financial targets.

All too often this creates the temptation to cut marketing budgets when earnings forecasts are at risk of being missed. Where evidence that spend on effective marketing can support financial benefits – such as sales growth or pricing strength – is either not known or not believed, such marketing cuts can seem a relatively low-risk step for a challenged company.

Based on the marketing-effectiveness insights collated by the IPA and many others, we believe that cutting marketing budgets damages brands and businesses, especially over time.[1]

Therefore it is in the interests of brand owners, the marketing industry and the economy as a whole to understand the assumptions and decision-making around marketing budgets more fully, and to develop solutions to help businesses avoid short-sighted cuts.

This report examines the contexts and beliefs around marketing expenditure. It includes the results of an exclusive survey from Brand Finance into perceptions about marketing among UK and US investment analysts.

Among analysts, our research found much increased scrutiny of corporate reporting on marketing and a desire for more transparency on marketing strategies. It also revealed an open-mindedness to changing how marketing expenditure is treated in financial accounting.

Building on those insights, this report aims to encourage corporate marketers to increase their efforts to persuade analysts and the wider investor community that spend on effective marketing, with the emphasis on brand building activities, is primarily an investment in a company's future, rather than a cost in its present.

We are conscious that changing attitudes to marketing is a marathon, not a sprint. The messages and recommendations in this report will need to be continually reinforced and supported by the right research and communication.

However, when it succeeds, this journey could cement understanding of the central role of marketing investment in generating long-term value for businesses.

Laurence Green,
IPA Director of Effectiveness

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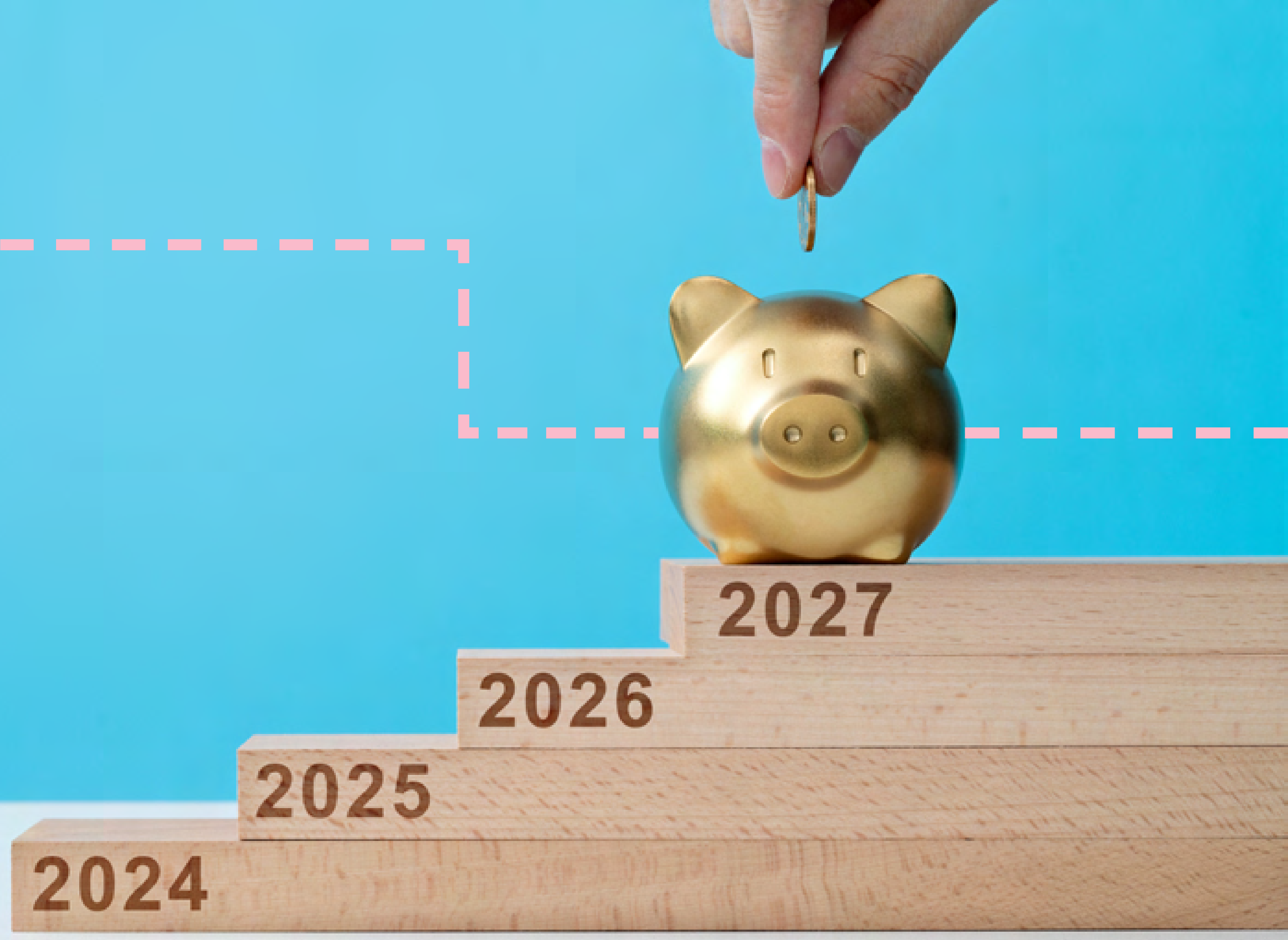
Summary



This report presents evidence and arguments for treating brand marketing as a sustained strategic investment in a company's long-term business priorities, and not simply as a cost to manage.

There are four parts to the report.

Part one briefly outlines the problem of why marketing expenditure is too often a victim of short-term budget cuts.

Part two includes exclusive new findings from an IPA survey with Brand Finance, the brand valuation and strategic consultancy, of perceptions about marketing among more than 200 UK and US investment analysts.

Part three discusses evidence of how maintaining marketing budgets has helped the recent pricing and profit performance of some major brand-owning companies.

Part four features recommendations on how marketers can make a more persuasive case that marketing can be a long-term investment in future business growth to a variety of financial audiences, from CFOs and boards to analysts and accounting bodies.

In company financial reporting, marketing expenditure is often labelled 'advertising & promotion' or 'A&P'. This is a term which encompasses both marketing for long-term brand building and the more promotional, activation side of marketing. This report uses the terms 'marketing' 'advertising & promotion' and 'advertising/brand comms' interchangeably when the totality of marketing activities and expenditure are being discussed. When brand building or activations are specifically being talked out, the report uses those more descriptive terms.

Investment analyst survey key findings

The IPA and Brand Finance surveyed 203 financial analysts of publicly listed companies in the UK and the US. They included both equity research analysts at investment banks ('sell-side' analysts) and analysts working for asset managers and others that invest in companies ('buy-side'). This online survey data was supplemented by selected qualitative interviews.

A 2005 IPA telephone survey of UK analysts had some of the same questions. Where relevant, we have compared responses from both surveys.

The 2023 survey findings are summarised here.

- Brand strength and marketing was the most cited factor by analysts for appraising companies.
- 80% of analysts in the 2023 sample examined marketing expenditure – a huge increase from 6% of the UK analysts surveyed in 2005.
- Analysts who regularly examined companies' marketing spend were more likely to see this spend as an investment and contributor to business growth.
- More analysts connected marketing to growing profit and sales volumes than to supporting brand pricing.
- Significant numbers of analysts thought marketing expenditure lacked transparency.
- Almost 90% of analysts believed marketing expenditure should be capitalised at least some of the time.
- Cuts in marketing spend were less negatively perceived than cuts in R&D spend.

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Evidence from major brand owners

We analysed recent announcements from prominent consumer packaged goods companies, including Unilever, Procter and Gamble (P&G), PepsiCo, Coca-Cola and Colgate-Palmolive.

Our analysis suggests that these companies view their marketing budgets as very much an investment, rather than a cost, and believe the benefits from their marketing investments include strengthened brands and pricing power.

The main evidence for this was:

- analysed companies reported a greater tolerance among consumers to accept big price increases than was predicted by analysts and some companies' own price elasticity models (namely, firms did not experience the predicted falls in sales volumes when the price of branded goods rose)
- in conference calls to investors and analysts, companies highlighted the contribution made by their marketing spend to the strength of brands in their portfolios and to the overall robust financial performance of their businesses

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How to make the case that marketing is an investment

It is vital to tackle the perception that marketing expenditure is a 'black hole' lacking transparency on where spend goes or how it works to generate longer-term financial value.

Therefore companies should provide analysts with more evidence of the long-term value created by effective marketing, particularly for its ability to support brand pricing. Access to detailed, relevant information will equip analysts to ask searching questions of managers announcing marketing cuts (and to demand effectiveness from marketers).

Marketers should take every opportunity to demonstrate that they fully understand their company's financial priorities and can explain how marketing supports these goals.

If marketers can persuade their colleagues that their activities contribute to the company's objectives and key financial metrics, if not shape them, they will be less likely to have their budgets viewed as a cost to be cut, rather than an investment to be maintained.

The investment case for marketing should be made using language credible to CFOs and the board.

Discounted cashflow (DCF) analysis is one method widely used by finance teams when evaluating investments. This method could be deployed more often by marketers to estimate the financial benefits of sustained marketing expenditure.

Marketers who can credibly employ techniques such as DCF models are demonstrating willingness to have their budgets discussed and evaluated in similar ways to other areas of long-term business investment.

We need to ensure that the evidence base about the financial benefits of expenditure on effective marketing is more widely known in financial communities, and that this evidence base is continually improved and updated.

Our survey of analysts provides fresh evidence for the debate about how financial accounting practices could better deal with marketing expenditure and brands. The data shows dissatisfaction in the analyst community with current practices.

The argument for change is that under accounting rules there is a mismatch between the period in which marketing spend is incurred and the longer timeframes in which sustained brand building marketing can create financial gains and develop brand assets.

The rules do nothing to encourage companies to view brand marketing budgets as long-term investments and to protect these budgets in tough times.

Reforms, such as re-classifying at least some brand building marketing expenditure as capex or valuing internally developed brands on balance sheets, are big steps to take. They would have potential implications for companies' profit reporting, tax positions, and brand valuation methods.

Accounting rules are also typically slow to change, reflecting their status as sets of international standards followed by millions of businesses and practitioners in the financial services.

Any movement for reform needs to build the widest possible base of support after debating the case for, and implications of, changing the rules governing the accounting treatment of marketing expenditure.

This report provides both evidence and arguments as contributions to this debate.

Part one:

The problem

Why is marketing often one of the first items to be cut when companies need to reduce spending quickly?

There are three interrelated reasons why marketing can be perceived by publicly listed companies as a low-risk area for spending cuts.

1. Even when business leaders view marketing positively, they often lack sufficient knowledge of, and confidence in, how marketing expenditure directly contributes to the company's longer-term financial objectives. Consequently, they can fail to see the full future downside to the business from cutting marketing budgets.

2. Pressure to meet the short-term financial targets of analysts and investors leads boards to look for quick savings when trading is tough. Cancelling planned marketing spend can seem a quicker, more temporary and less disruptive decision for the company than cutting other types of operating expenditure.

3. Accounting rules can provide an incentive for companies to cut marketing budgets as a short-term boost to their profits, especially in tough trading conditions. The rules do not recognise that marketing spend incurred in one accounting period can generate financial benefits and create brand assets over a longer timeframe. They therefore do nothing to encourage companies to view brand building marketing as a long-term investment.

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1. Board support for brand building has shallow roots

Senior managers have a positive – but sometimes weak – understanding of marketing and its value

In the 2019 joint *Financial Times* (FT)/IPA report, *The Board-Brand Rift*,[2] 76% of C-suite business leaders agreed that they understood how strong brands continually delivered to the bottom line (Figure 1).

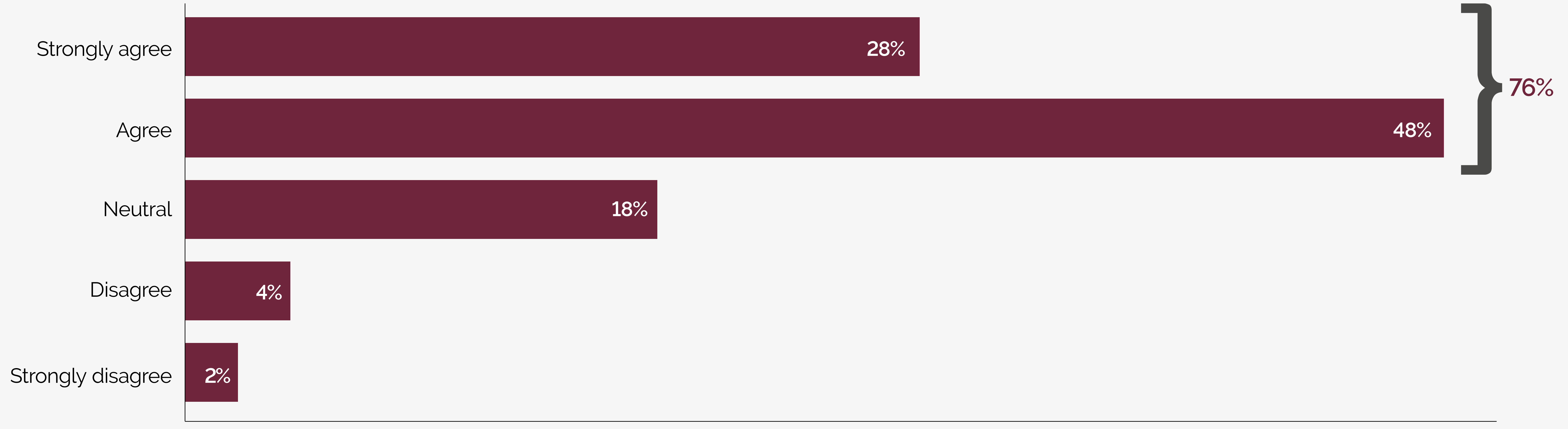
However, over 50% of business leaders described knowledge of brand building in their boardrooms with adjectives ranging from 'average' to 'very poor', and only 8% described it as 'excellent' (Figure 2).

Non-marketers were significantly less likely than marketers to highlight the importance of brand strength for establishing new revenue streams, reducing customers' price sensitivity, and improving profitability for instance.

Since boards mostly comprise non-marketers, this suggests leadership support for building the company's brands via effective marketing spend has shallow organisational roots.

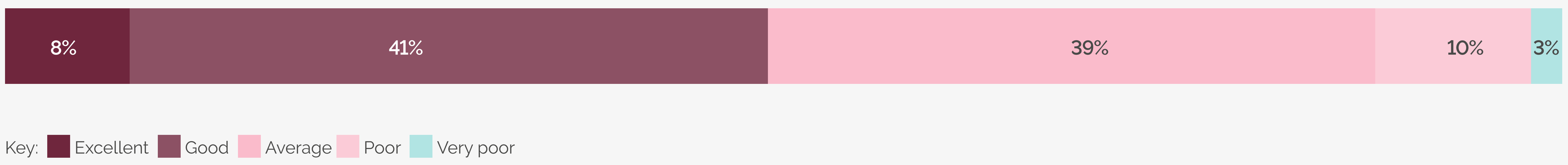
This makes it easier for decision-makers to downplay the full impact on the future performance of the business when making marketing budget cuts.

Figure 1: 'As a leadership team, we understand how a strong brand continually contributes to the bottom line of the business'



Source: *The Board-Brand Rift* FT/IPA 2019

Figure 2: More than 50% of business leaders rated knowledge of brand building in their organisations as average to very poor



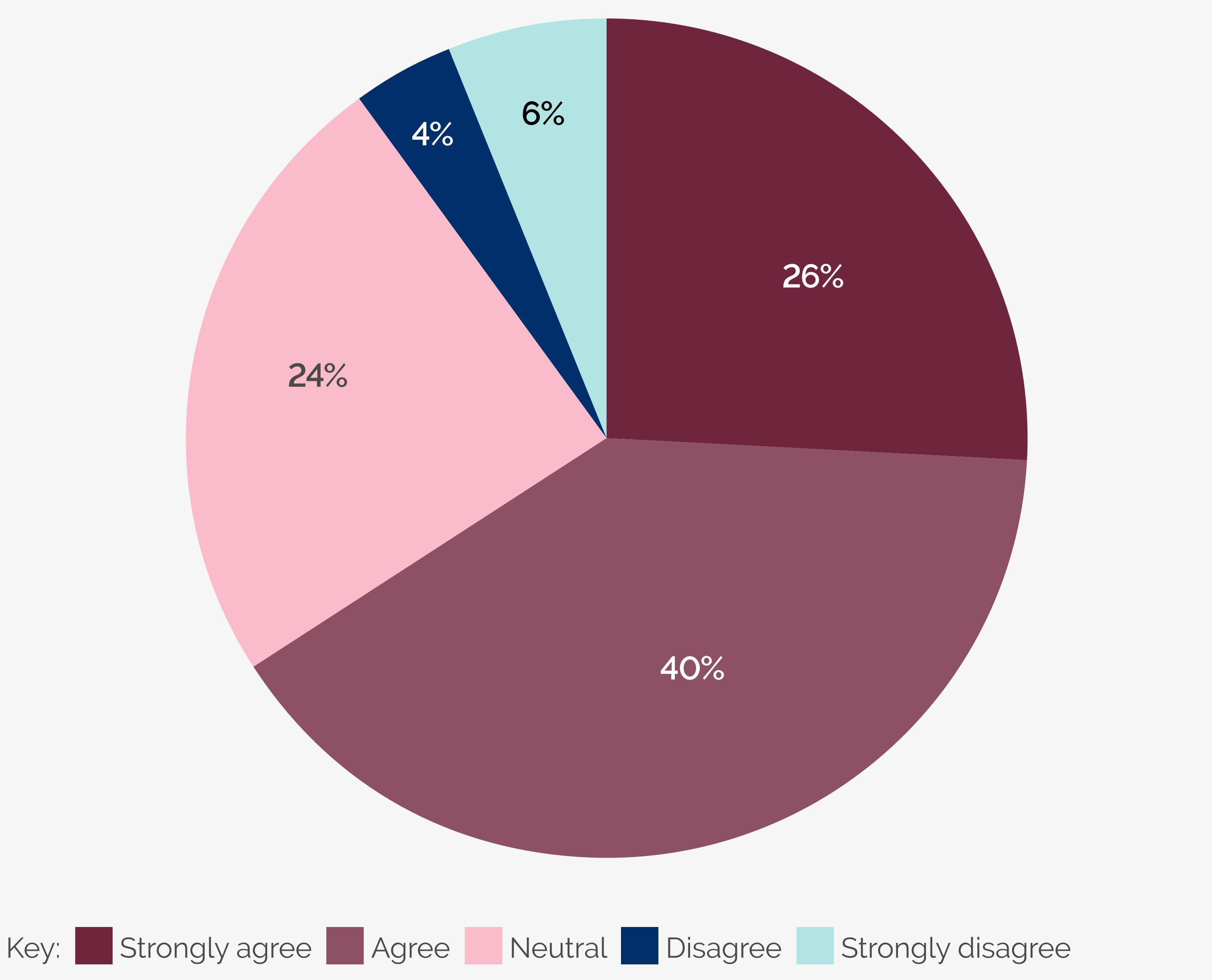
Source: *The Board-Brand Rift* FT/IPA 2019

2. Managements are under pressure to meet short-term targets

Financial markets' short-term focus compounds issues

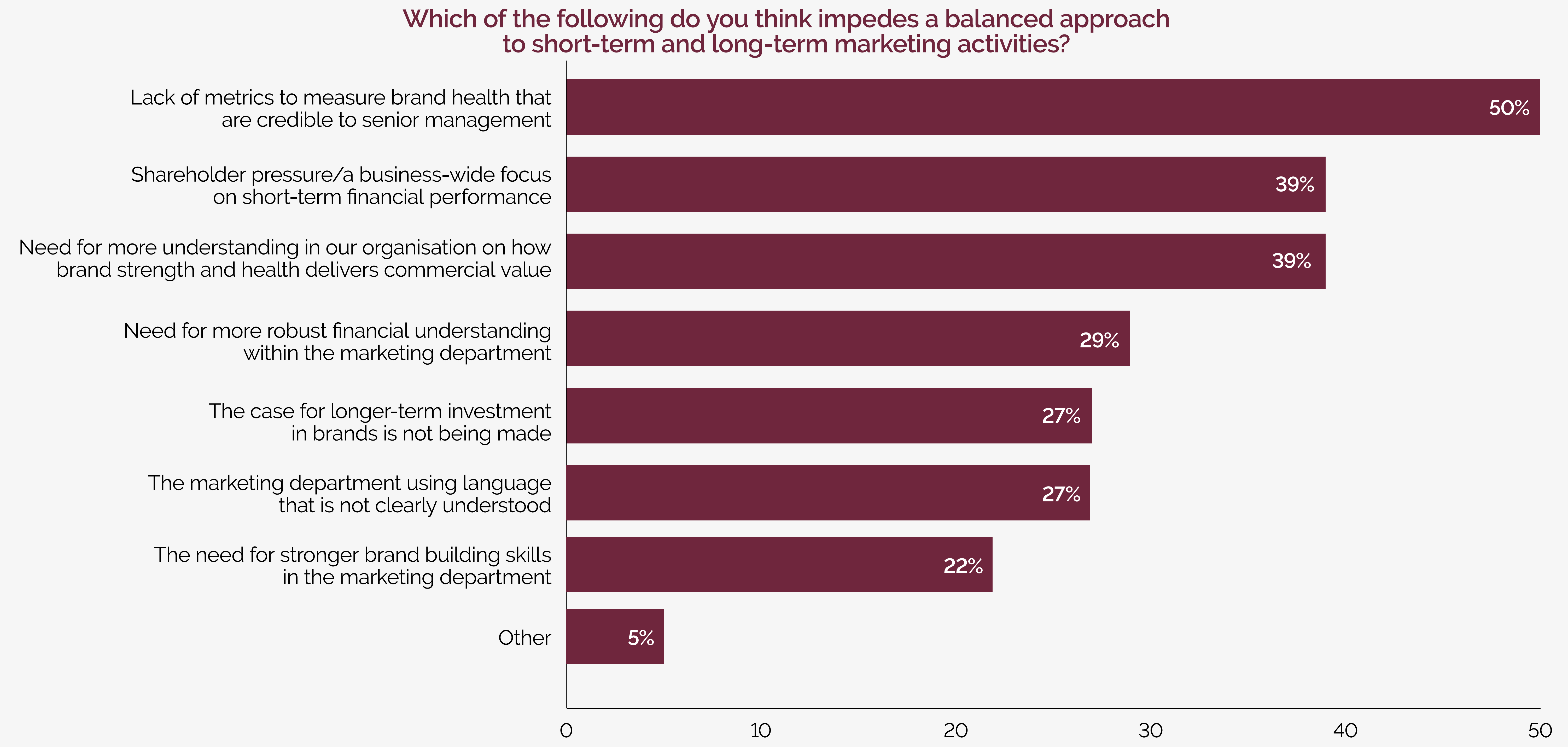
In the FT/IPA research, 66% of respondents agreed that a balance of short-term and long-term marketing activities delivered better returns for the business (Figure 3).

Figure 3: Percentage agreeing/disagreeing with the statement 'A balanced approach to short-term and long-term objectives delivers better returns'



Source: *The Board-Brand Rift* FT/IPA 2019

Figure 4: Many factors are perceived to impede businesses from developing a balance of short-term and long-term marketing activities



Source: *The Board-Brand Rift* FT/IPA 2019

In the same study 39% said 'shareholder pressure or a business-wide focus on short-term performance' impeded getting this balance right (though lack of credible brand metrics was cited as an impediment by 50%) (Figure 4). In addition, in every global region surveyed, respondents said their organisations' reporting cycle for marketing was getting shorter.

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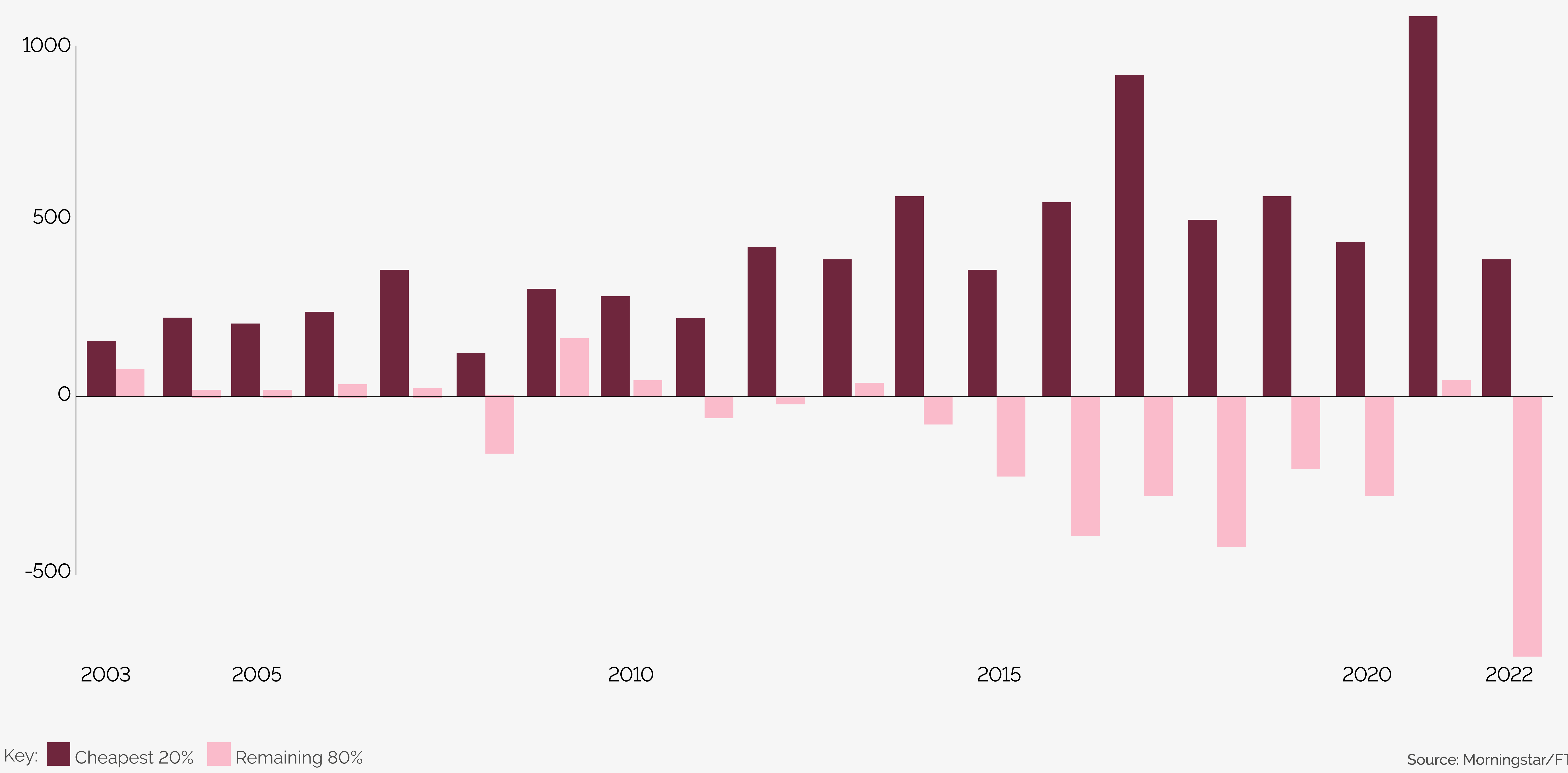
Every six months UK- listed companies report full results; for US-listed companies, this reporting requirement is quarterly. This means business leaders face a regular series of short-term targets against which the performance of their business and its leadership is being judged by the financial markets.

In recent years, the participants in those markets have been changing. There has been a rise in so-called 'activist' shareholders. The reputation of such shareholders is that when they perceive businesses are underperforming they are more likely than traditional investors to take high-profile actions, like increasing their stake in the company, criticising it in public, or lobbying to gain a seat on its board.

Another trend is the increased volume of market investment from exchange-traded funds (ETFs). ETFs typically contain a basket of different shares and aim to track the broader movements in a share index, often using algorithms to decide when to buy and sell shares. This differs from 'actively' traded funds where fund managers try to outperform an index by anticipating market movements and weighting their investment portfolio accordingly.

As Figure 5 shows, the cheapest 20% of funds on the US market have seen significant net inflows of funds from investors in recent years. The reason why this matters here is that the algorithmic

Figure 5: Net inflows/outflows ($bn) from US funds according to the amount of fees that funds charge (August 2023)



Source: Morningstar/FT.

software that ETFs use primarily analyses the results and sentiment in a company's financial reports against the market's expectations to drive its share trading.

Companies that underperform those expectations – even if they have made the case that it was better for the long-term performance of the business to keep spending and take a short-term hit to profits – may see the influence of share trading by ETFs in a bigger than expected share price fall.

The upshot of these recent trends is to re-affirm the importance for the leaders of listed companies of consistently meeting the markets' short-term earnings expectations.

If a company misses these targets, its share price (and therefore its market capitalisation) will inevitably suffer. A persistently weak share price will affect its ability to raise new share capital or use its shares to acquire other businesses. Management will be at risk of being replaced. At the very least, they could miss out on significant elements of their remuneration linked to the value of the company's shares.

The continual need to manage financial markets' expectations is one factor pushing the leaders of listed businesses towards shorter-term decision-making on how companies use their cash in general. According to a *Financial Times* report in October 2023, investment horizons at the world's largest companies have fallen to their shortest since the think tank FCLT began analysing this type of data in 2009.[3]

In the context of marketing spend, this overall business trend towards short-termism should be seen in combination with the evidence cited in Figure 4 of the perceived lack of credible marketing metrics and weak understanding among business leaders of how marketing contributes to business priorities.

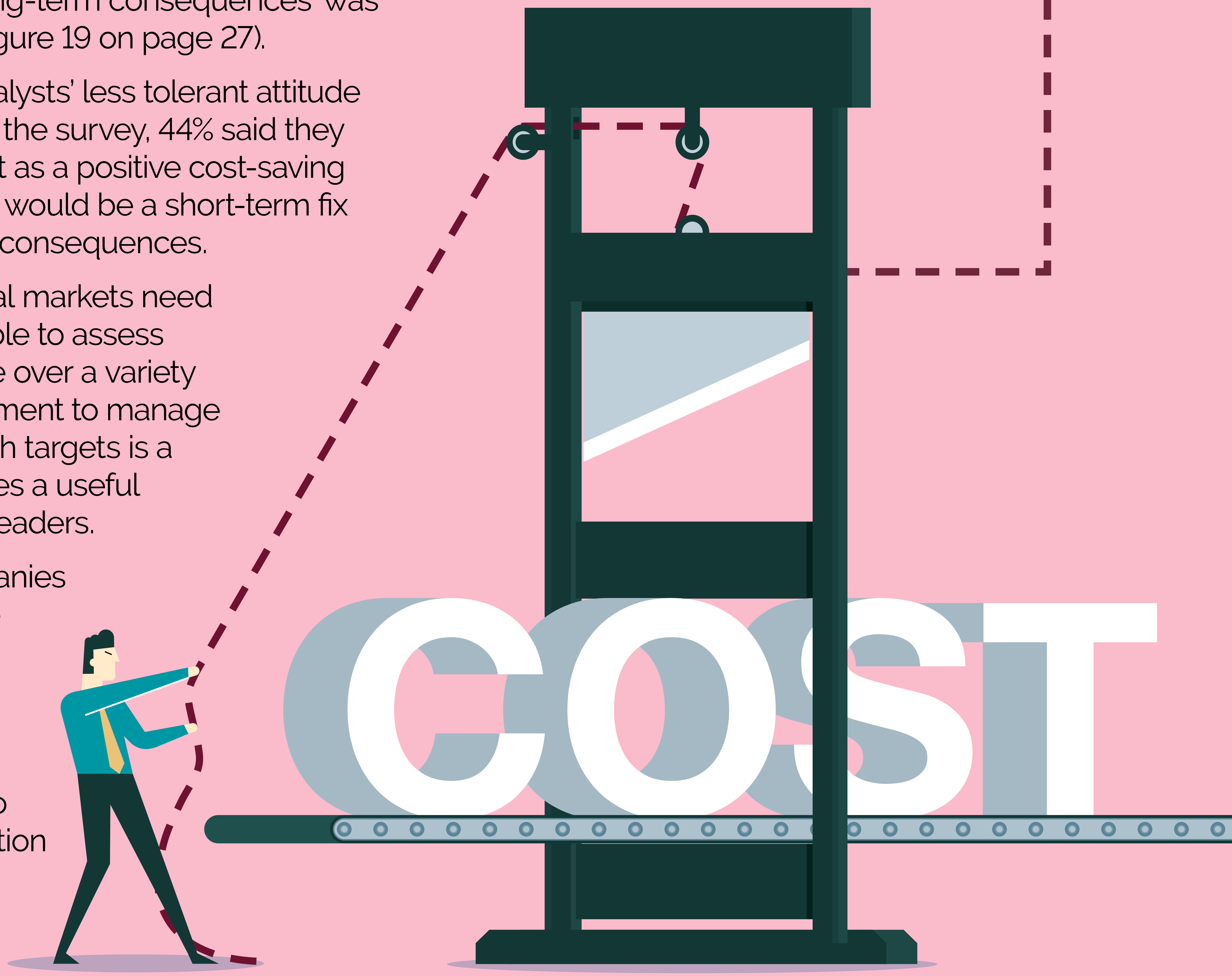
Against this backdrop, it is easy to see why, when trading conditions are tough, boards can regard axing planned marketing spend as a relatively quick and low-risk cost saving to make if it increases the chances of hitting profit forecasts and keeping financial markets onside.

In the IPA/Brand Finance survey more than half (52%) of investment analysts said they would perceive a marketing spend cut as a positive cost-saving measure. The view that the cut would be a 'short-term fix with negative long-term consequences' was only held by 36% (see Figure 19 on page 27).

Contrast this with the analysts' less tolerant attitude to a cut in R&D spend. In the survey, 44% said they would regard an R&D cut as a positive cost-saving measure, and 47% said it would be a short-term fix with negative long-term consequences.

The reality is that financial markets need earnings targets to be able to assess companies' performance over a variety of timeframes. A requirement to manage expectations around such targets is a fact of life (and sometimes a useful discipline) for company leaders.

It is incumbent on companies to keep making the case why their marketing expenditure effectively contributes towards the performance of the business. They can do so by sharing more information on marketing spend and strategies with analysts and investors.



3. Accounting rules do nothing to encourage marketing to be seen as a long-term investment

How companies report their financial position also matters

Accounting rules in key company financial statements also affect how marketing and any cuts to marketing budgets can be viewed.

To appreciate why, it is necessary to look at the three key financial statements for companies:

The **profit-and-loss account** (P&L), also known as the income statement, reports the company's reported revenues minus its costs to give its profit or loss result for the accounting period. Note, this is not the same as the actual cash inflows and outflows experienced at the business during the period, which is covered by the cashflow statement discussed below.

The **balance sheet** shows the assets, liabilities, and equity of the business. Its assets cover what a company has in current or future economic value. Relevantly for us, brands that are developed by a company are not valued as assets on the balance sheet, though the costs associated with acquiring brand assets from another business are. Liabilities are what a company owes, and the equity is the total value of the company's shares.

The **cashflow statement** shows actual changes in the company's cash finances over the period. The cashflow statement is crucial because accounting policies provide some freedom regarding the way companies report items in their P&L and this will affect the overall profit or loss figure they report in any period. The company's cash position will be unchanged by this accounting treatment.

Why are these financial statements relevant to our discussion of marketing? The brief answer is to do with how companies treat their main costs for accounting purposes.

Operating expenditure (opex) comprises those expenses incurred as part of the business-as-usual running costs of the company. Examples include staff salaries, rent and utilities bills, insurance, office supplies, and other overheads classified as part of the cost of goods or services provided by the company. Marketing in any form is also categorised as opex. This is despite the evidence that marketing spend in one year can create longer-term value and company brands nurtured through marketing can be very valuable enduring assets.

All opex costs are fully expensed in the P&L in the accounting period in which they were incurred.

Capital expenditure (capex) is the category for the company's expenditure, typically on bigger, more fixed assets, such as land, buildings, major equipment, or software. These are considered not just costs but investments in assets that will provide value to a company over several accounting periods, and they are therefore deferred

to (or capitalised on) the balance sheet. Then, over time, these costs will be recognised in the P&L via depreciation charges for tangible assets and amortisation charges for intangibles, with a corresponding adjustment in the carrying value of these assets on the balance sheet. Accounting rules provide some freedom as to the period, and the rate, at which these costs are recognised on the P&L. (See Appendix for more detail).

These practices enable companies to spread over several years the impact of capex spending on their P&L (though not their cashflow statement). Otherwise, they might be disincentivised from making long-term business investments.

Why marketing can seem an easy budget to cut – and accounting rules don't help

When a business is struggling commercially, it is normal for its leaders to look for potential quick spending cuts to boost the company's chances of meeting its profit targets, and sometimes also to conserve its cash.

It could freeze future capital expenditure. But, as explained above, only a fraction of capex impacts the P&L through depreciation and amortisation charges in any one accounting year. These charges may relate to cash already spent in previous years that can't be reduced. Because capex relates to longer-term business investment, any big reduction in capital spending could also be seen as a lowering of the company's future growth ambitions, which could lead analysts to downgrade their earnings forecasts for the company anyway.

So it is understandable that companies will look mainly to their operating expenditure if they want to make quick and impactful spending cuts to improve their financial position.

Perhaps a more important question is why, when businesses look at all the areas counted as operating expenditure, managements will often view marketing spend as one of the areas that can be most significantly and rapidly reduced at relatively low perceived risk to the business.

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Opex items, such as staff salaries, rent or utilities bills, or technology licences are much more like fixed costs on the business. They can't easily be cut or negotiated down at speed.

A struggling company may have some room to reduce its labour costs. For instance, it may not pay staff bonuses or could choose to reduce project consultants and freelance contractors. These are unlikely to provide either a quick or sizable fix and could make the company less productive. If there are actual staff job cuts, these will usually involve some short-term costs and disruption for the organisation.

Other areas of opex, such as spending on travel or staff entertainment, could also be reined in. But these budgets are too small for these cuts to make a sufficient difference by themselves. Other overheads more directly associated with the cost of goods sold (COGS) may go down in total anyway if the company is selling fewer units.

In contrast, marketing can seem to be one relatively large cost over which the company has greater discretion to decide how, when and whether this will be incurred.

It is not difficult to see why, for those managers who are unclear or sceptical about the value marketing expenditure creates for the business, cutting the marketing budget in a challenging environment might seem one of the easier decisions for the organisation to take. Ironically, even arguments used to champion marketing are often turned against future spending on the grounds that if the business did a sufficiently good past job marketing its brands, then these brands probably would not decline, at least for a time, if expenditure halted.

The key phrase here is 'for a time'. Companies at risk of missing short-term earnings forecasts – and the consequences that will follow from this underperformance – are looking to buy themselves time for the business to get back on track with market expectations.

Cutting marketing expenditure can seem a relatively painless way to purchase this breathing space.

However, in the near term, it can make the business vulnerable to competitor advertisers that use budgets to increase their own 'share of voice' in the market.[4] If cuts are prolonged, they will damage the strength of the brands owned by the business and their contribution to metrics, such as organic growth and sales price. Businesses should argue that spending on brand building marketing is primarily an investment in their future, not a cost in their present. Marketing cuts will put their future growth rate at risk.

Part two: Investment analyst survey findings

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The IPA would like to thank the following people for the development and analysis of this survey and its findings:

Annie Brown,
General Manager,
Brand Finance UK

Fran Cassidy,
Owner, Cassidy Media Partnership,
and *IPA consultant*

In 2023 the IPA commissioned an online survey from Brand Finance, the brand valuation and strategic consultancy, of 203 financial 'buy-side' and 'sell-side' analysts from the United Kingdom and United States.

This research was designed to ascertain the views of analysts covering different industries. Analysts were questioned about expenditure by publicly listed companies on what is often called in financial reporting contexts 'advertising & promotion' (A&P). This report treats 'A&P' interchangeably with the more generic term of 'marketing expenditure' used in general business contexts.

This quantitative survey was complemented by several deeper-dive, one-to-one qualitative interviews with analyst respondents. In addition, several questions in 2023 were the same as those in a 2005 telephone survey of 50 UK analysts published by the IPA. Where it is relevant, we have provided some comparisons between the results of both studies.

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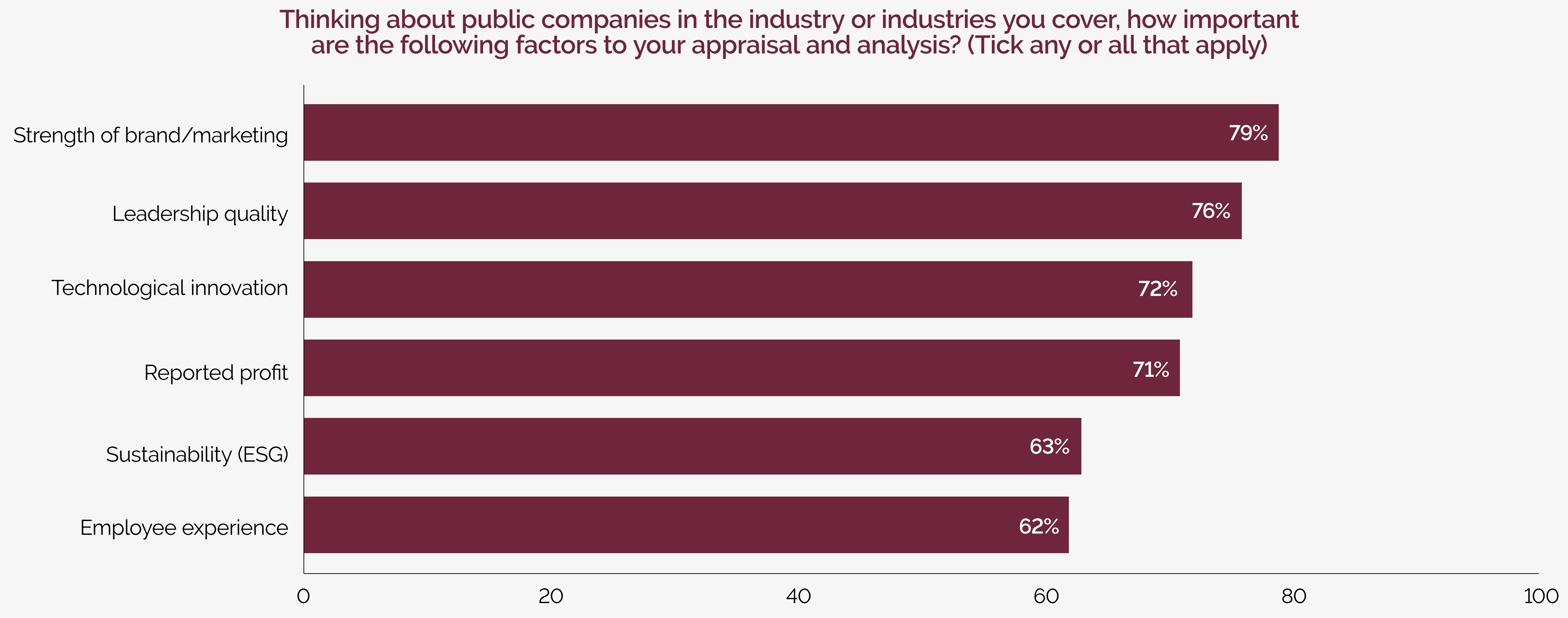
Investment analyst research

Figure 6: Brand strength/marketing is the most often cited factor by analysts in appraising companies



Source: Investment analysts research 2023 – IPA and Brand Finance Total sample; Unweighted; base n = 203

The strength of a company's brands and marketing was the factor most cited by analysts as important to their appraisal of businesses

Analysts were given a list of six factors (Figure 6) and asked to say which were important to them when appraising the publicly listed companies in the categories they covered. Respondents could choose any or all of the factors.

The strength of a company's brands and marketing was most often selected with 79% of respondents choosing this factor. This characteristic was more often cited than the quality of the company leadership (76%), its technology innovation (72%), or its reported profit (71%).

While all the factors were considered important by the majority of respondents, it is the fact that brand strength/marketing was the most chosen that is worth noticing.

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Analysts understand that advertising and brand communications help key business metrics, such as sales and profit, but are less likely to see their benefits on pricing

Analysts recognised that advertising and branding help key financial metrics. As Figure 7 shows, survey respondents were most likely to cite profit margin (77%) and sales volumes (71%) as financial metrics that advertising and brand communications benefited. This was ahead of market share (66%), sales price (54%) or cashflow (52%).

Notably, on sales price, the overall figure of 54% could be split into the figures among analysts covering B2B companies, which was 45%, and a much higher figure of 76% among analysts of B2C companies.

When analysts were asked (Figure 8) which one metric benefited most from marketing expenditure, support for sales volume (31%) and profit margin (28%) were both more than three times higher than that for sales price (9%).

This is an interesting finding given what this report discusses later about the strategy of major brand owners in recent years to invest in marketing to strengthen their brands' pricing power.

Figure 7: Factors impacted by advertising and brand comms

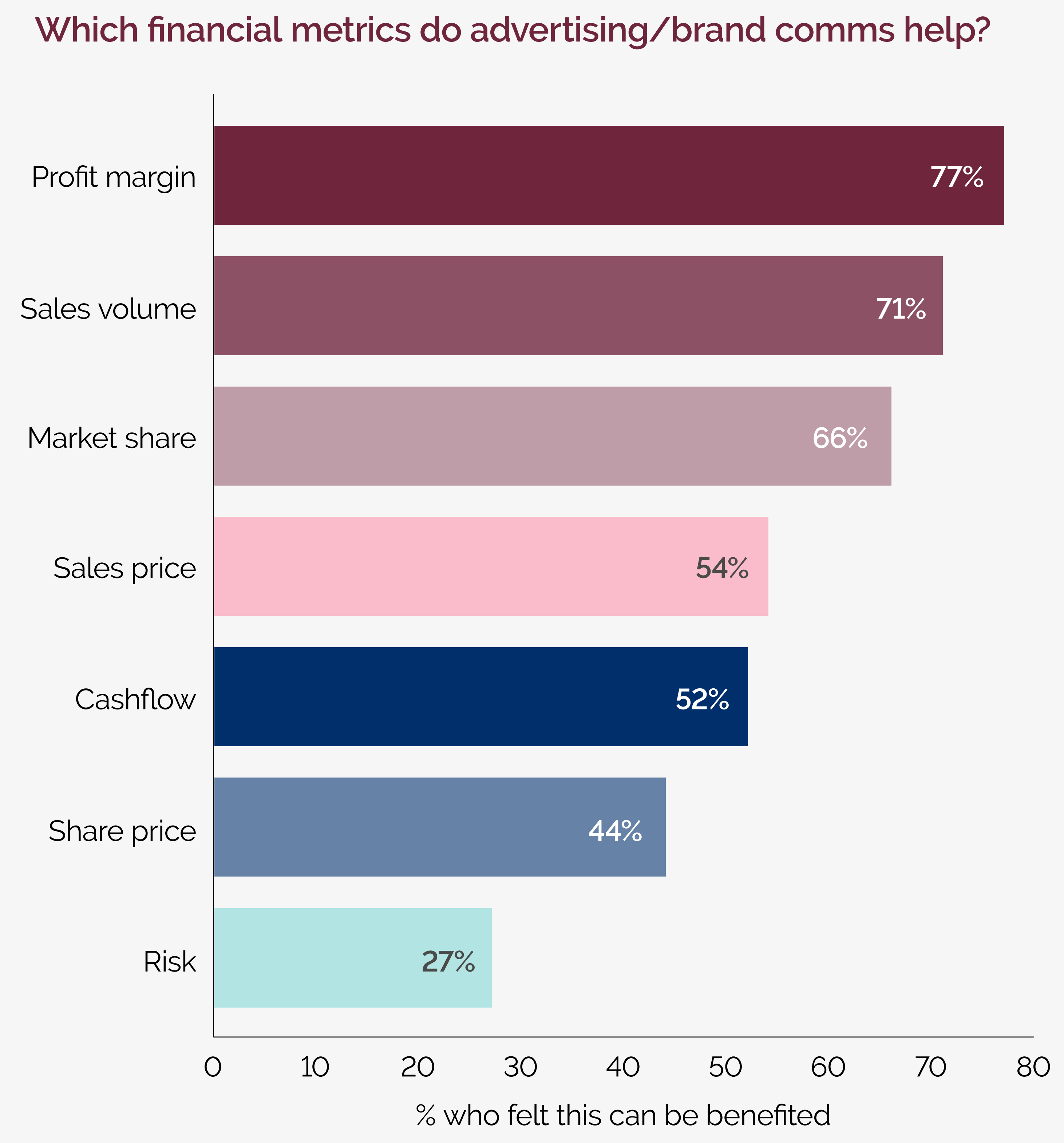
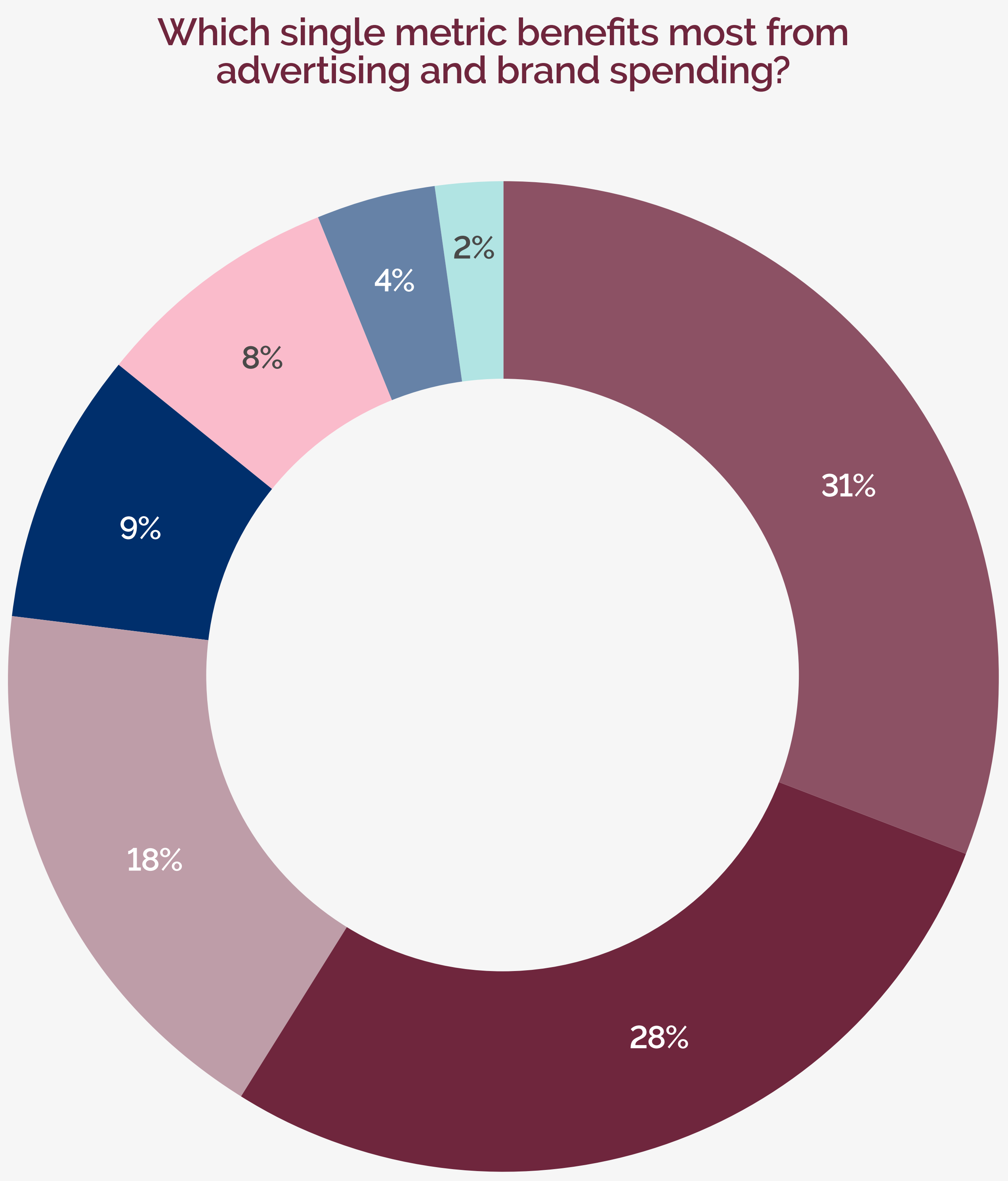


Figure 8: Factors impacted by advertising and brand comms



Key: Profit margin, Sales volume, Market share, Sales price, Cashflow, Share price, Risk

Source: Investment analysts research 2023 – IPA and Brand Finance   Total sample; Unweighted; base n = 203

Most analysts examined A&P spend in the companies they followed

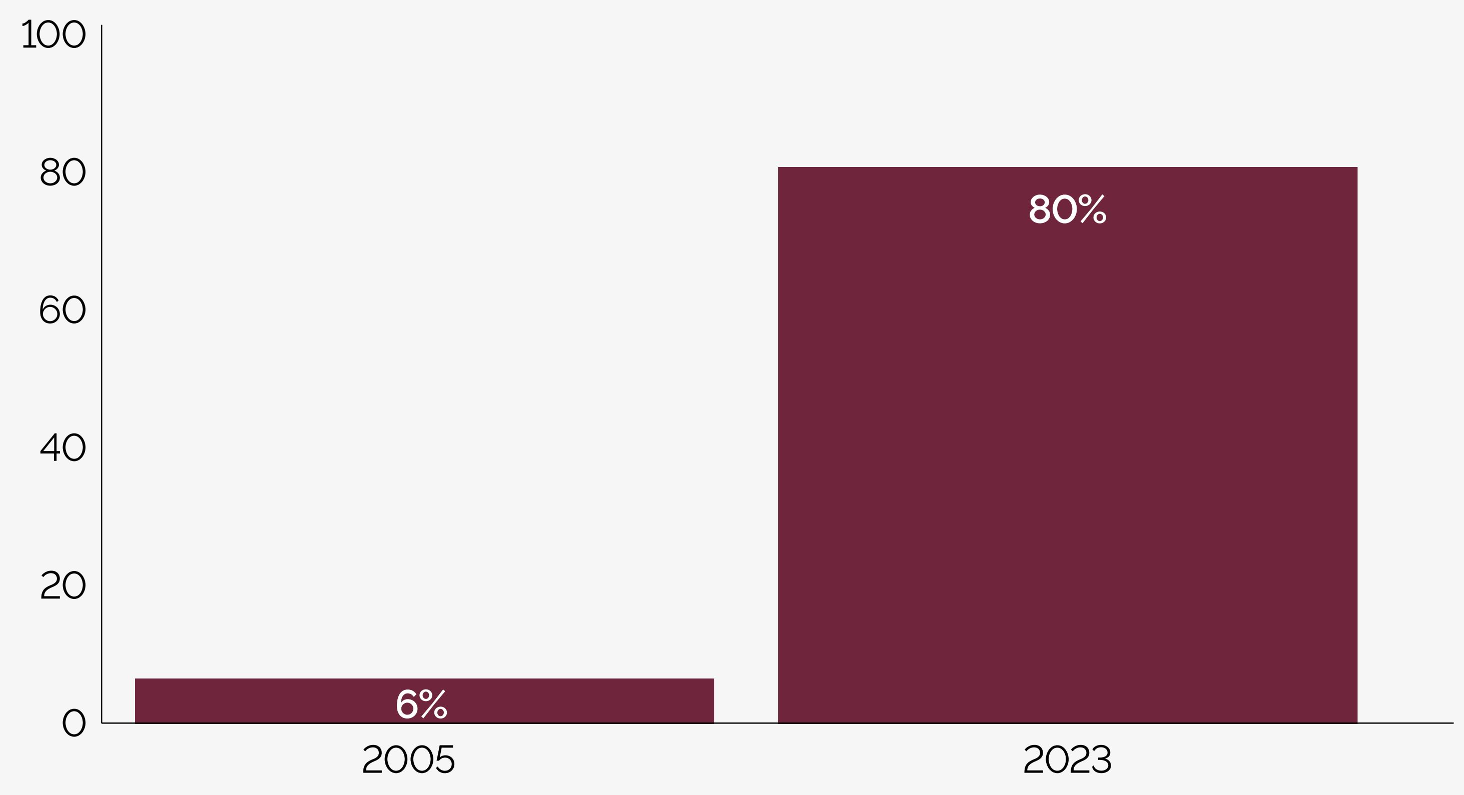
Overall, 80% of analysts surveyed in 2023 said they analysed the A&P expenditure of the companies they followed (Figure 9).

Analysts of B2C companies were more likely (86%) than analysts of B2B companies (74%) to look at A&P spend (Figure 10).

However, a more useful contrast is with the overall figure from the 2005 telephone survey of UK analysts when a similar question was asked. In 2005, only 6% of analysts said they examined A&P budgets.

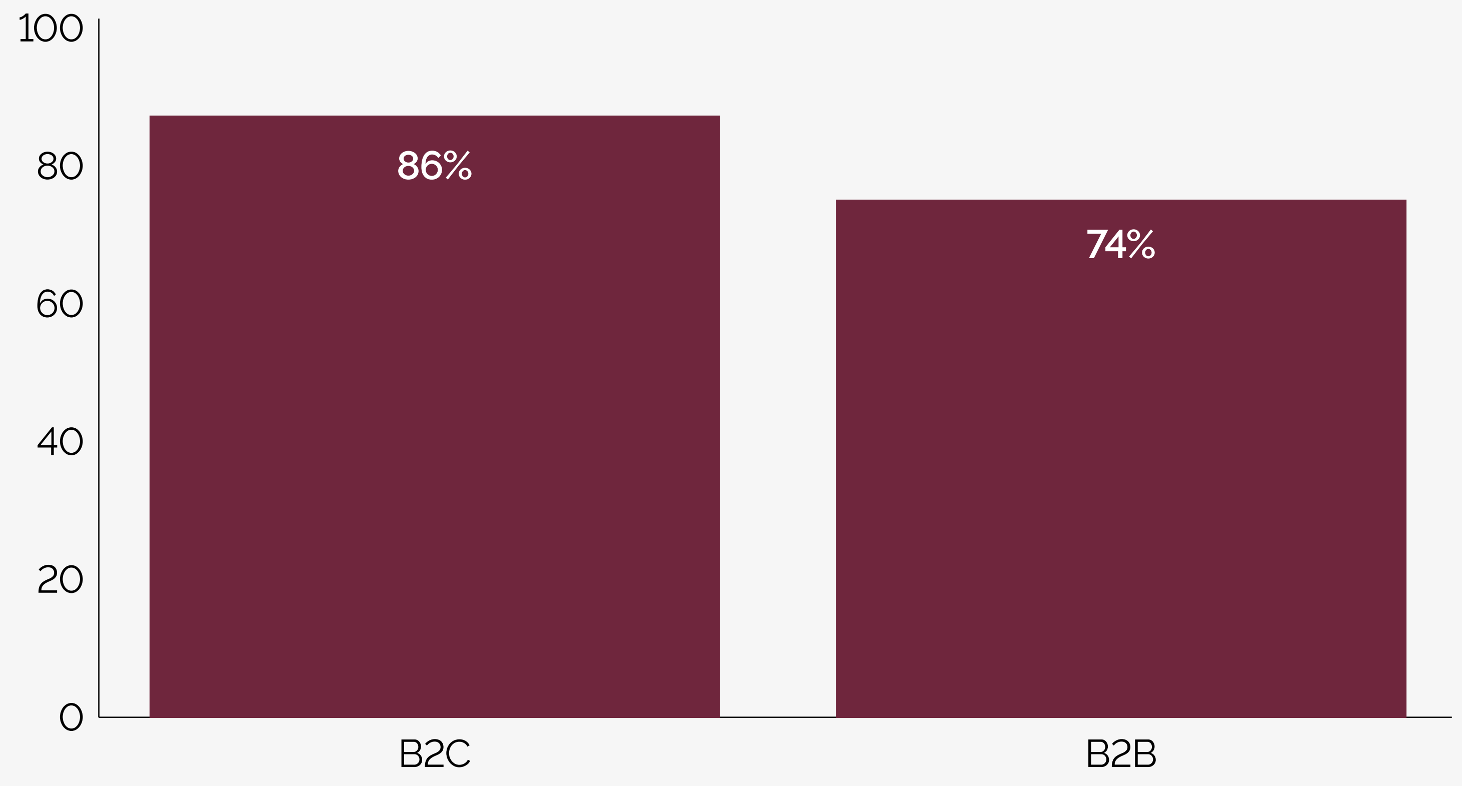
The striking difference in the answers from both surveys probably reflects greater interest within financial communities about marketing spend.

Figure 9: % currently do analysis on A&P



Sources: IPA 2005 survey, base n = 50; Investment analysts research 2023 – IPA and Brand Finance Total 2023 sample; Unweighted; base n = 203

Figure 10: Do you currently do analysis on the A&P of the companies you track?



Source: Investment analysts research 2023 – IPA and Brand Finance Total sample; Unweighted; base n = 203
Note on industry groupings: respondents grouped in a way so that there is less cross-over effect. People qualify to be a B2C respondent by their absence of coverage of B2B industries (i.e. they could cover FMCG and Automobiles but they do not cover Engineering.)

A significant proportion of analysts thought marketing and the returns from marketing lacked transparency.

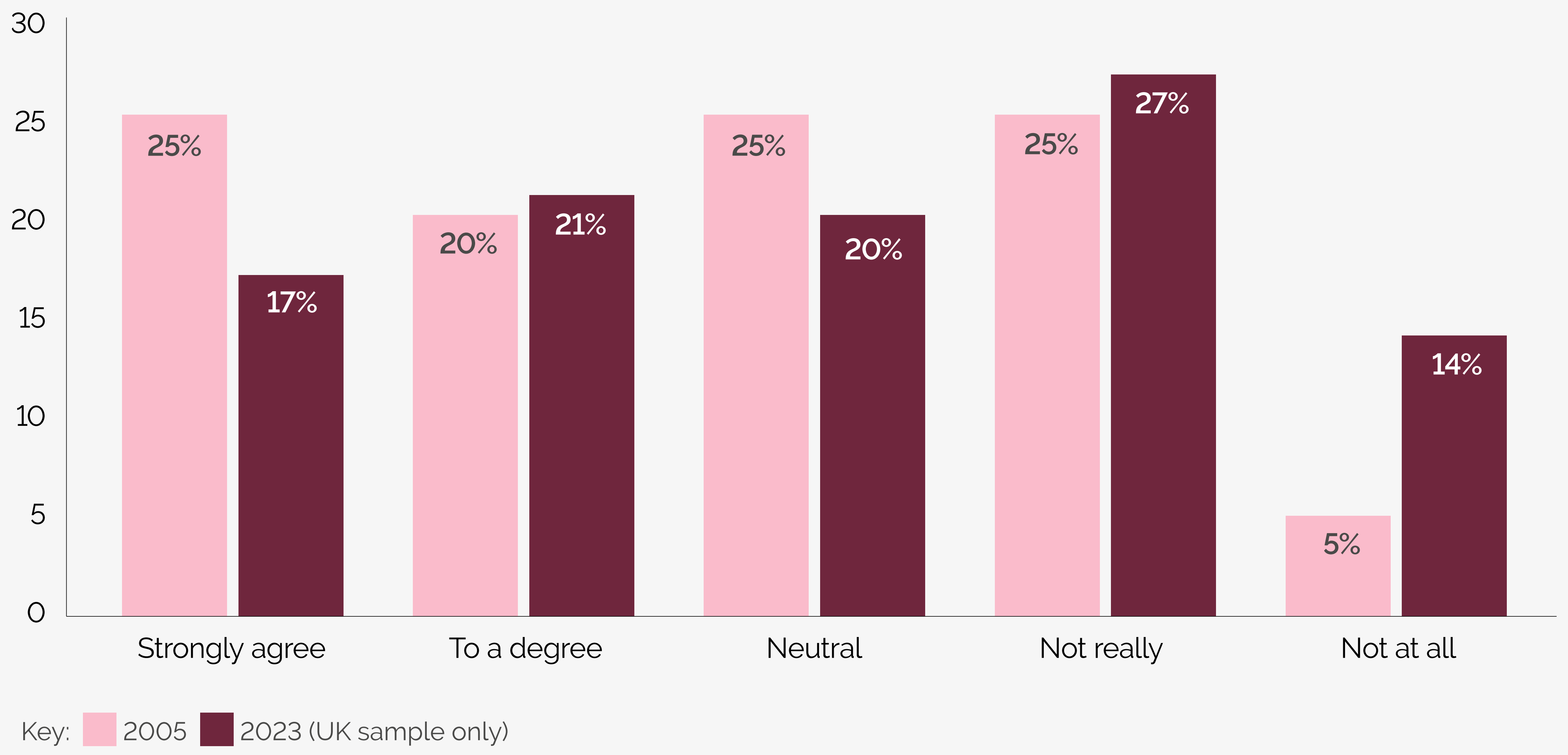
Another question asked in both the 2023 and 2005 surveys was the degree to which analysts believed marketing expenditure could be, to use a colloquial phrase, 'a big black hole'. As Figure 11 shows, UK respondents in the 2023 survey were less likely to agree that marketing was a black hole than the UK analysts surveyed in 2005. However, there were still 38% of UK respondents[5] in 2023 who agreed with the 'black hole' description either strongly or to a degree.

In the 2023 study we added a question about whether all respondents agreed with the statement 'Is return on marketing a 'big black box'?'

As Figure 12 shows, 30% did not agree with the 'black box' view of return on marketing.

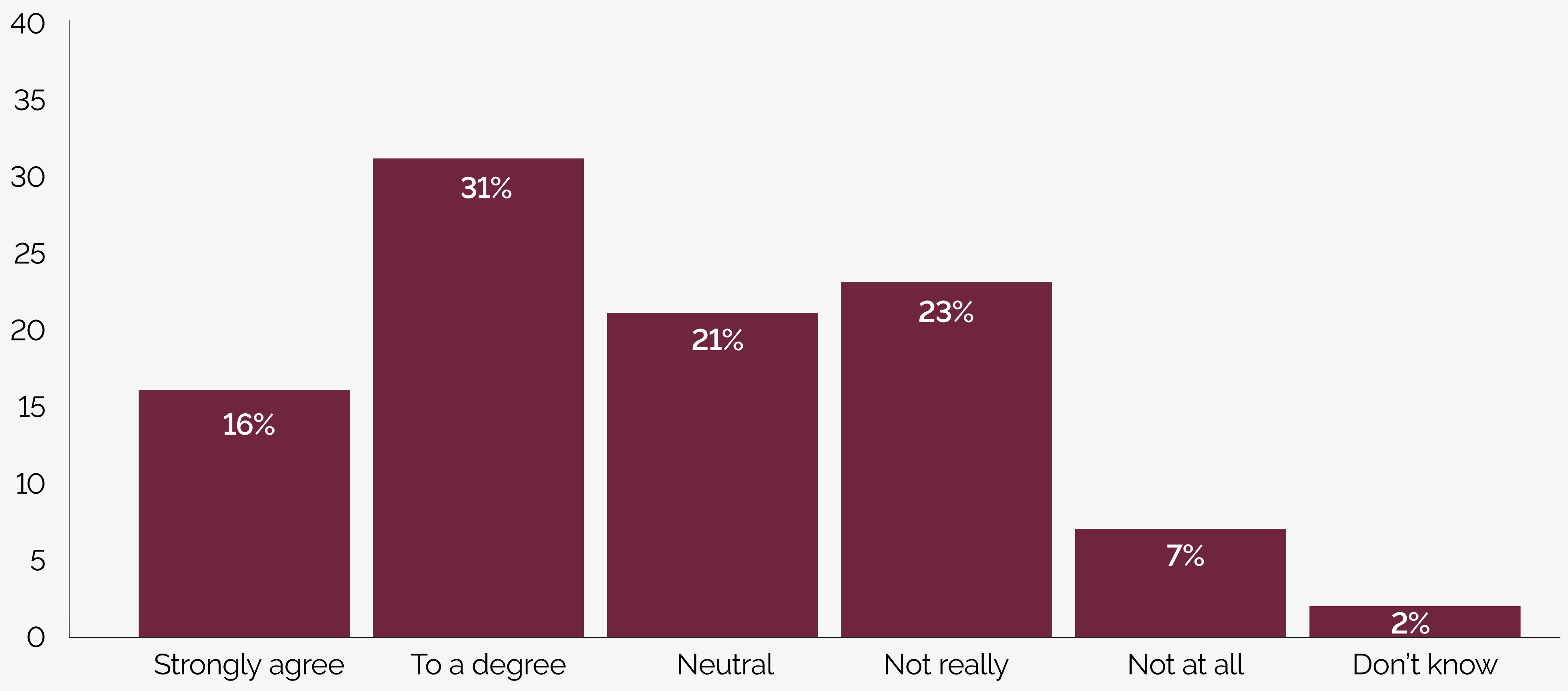
However, nearly half of respondents confirmed their scepticism about the transparency of returns from marketing by agreeing with the term.

Figure 11: Marketing expenditure is a 'big black hole'



Source: IPA 2005 survey; Investment analysts research 2023 – IPA and Brand Finance Total 2023 sample; Unweighted; base n = 203

Figure 12: Is return on marketing a 'big black box'?



Source: Investment analysts research 2023 – IPA and Brand Finance Total sample; Unweighted; base n = 203

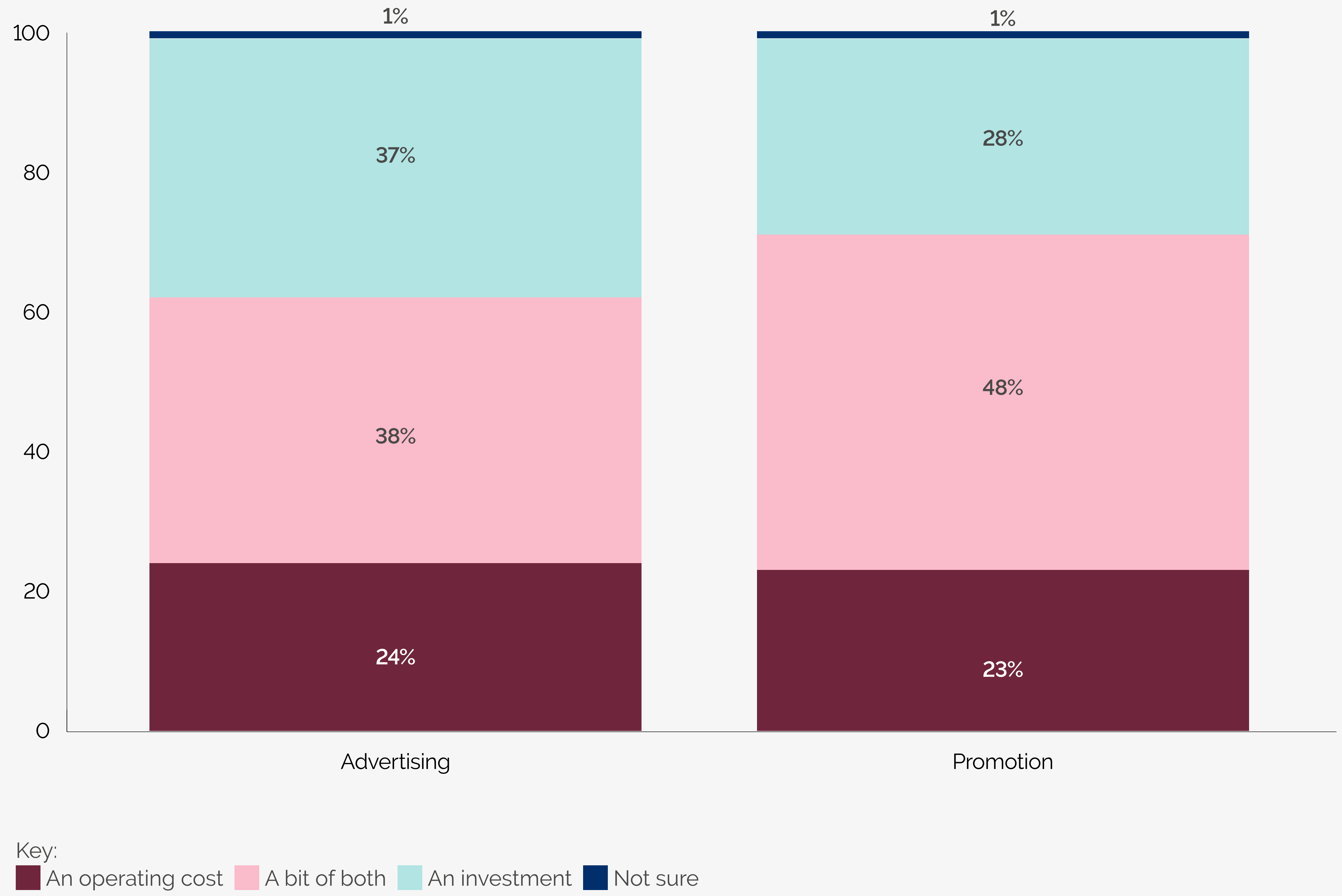
Analysts are divided on which types of marketing are investments, costs or a mix of these

In the 2023 survey, analysts were asked to look at advertising and promotion separately and say whether they thought each type of spending was an investment, an operating cost or a mixture of investment and cost. For both advertising and promotion, the biggest group of analysts saw each of these spending categories as a mixture of investment and cost (Figure 13).

However, analysts' view of advertising was more weighted towards investment with 37% of analysts seeing advertising as an investment, whereas only 28% of analysts thought promotion was an investment. About equal numbers of analysts saw advertising or promotion as an operating cost (24% and 23% respectively).

This can be taken as evidence that the advertising and marketing industries need to do a better job of explaining that promotion (for instance, running a two-for-one price offer without other marketing activity to build awareness or consideration for the brand itself) is almost wholly a cost. Conversely, if advertising is effective, much of its value will be generated in the medium to long term, which makes it more like other types of business investment.

Figure 13: When thinking about types of marketing spend, companies often refer to advertising and promotion (A&P). How would you define the nature of that spending?



Source: Investment analysts research 2023 – IPA and Brand Finance Total sample; Unweighted; base n = 203

Nearly 90% of analysts thought at least some of the time marketing spend should be similarly treated to technology R&D as capital expenditure for accounting purposes

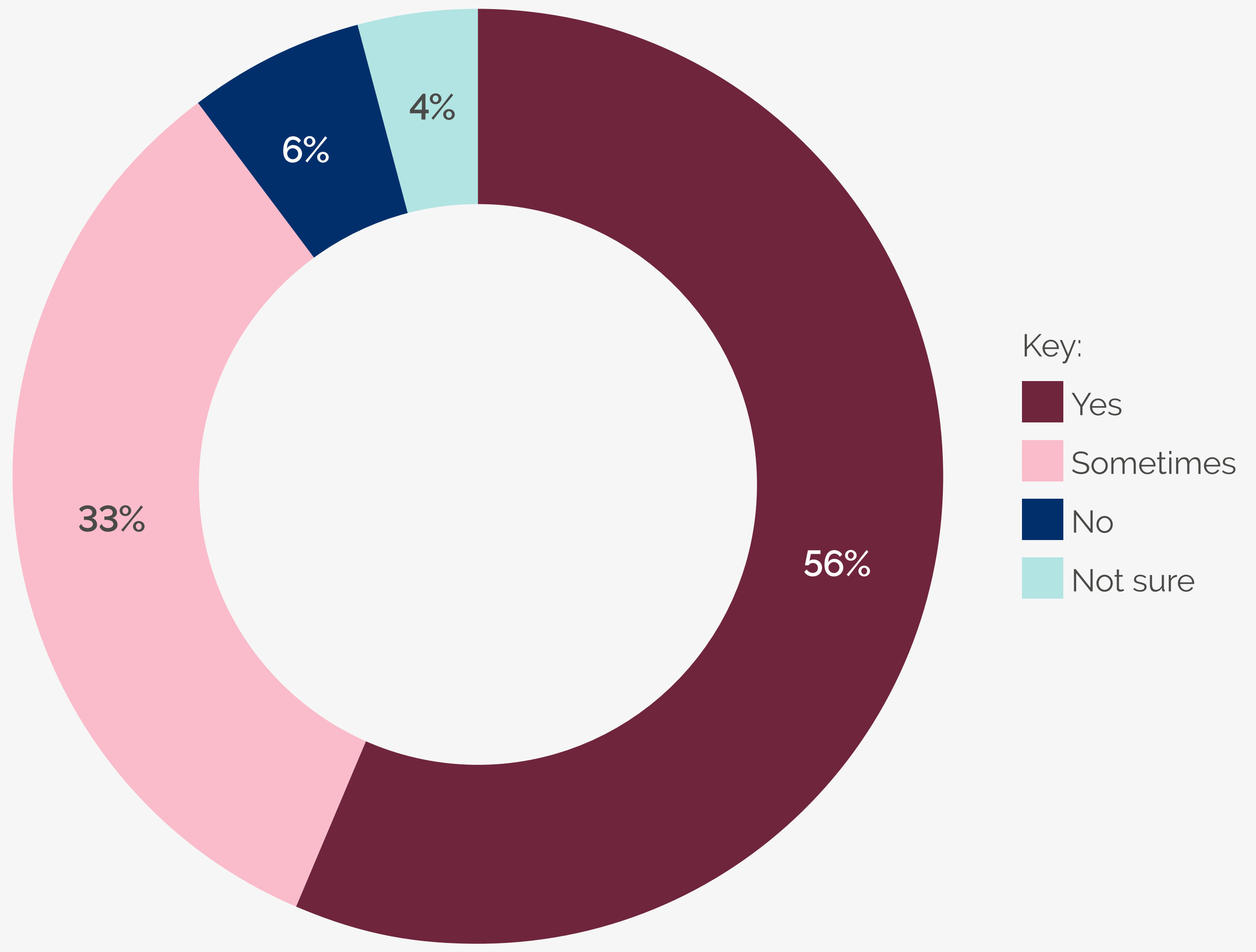
One of the most important aims of our survey was to gain a better understanding of analysts' views of the accounting treatment of marketing expenditure. Currently, marketing expenditure is treated as operating expenditure and fully expensed within the accounting period in which it was spent.

However, 89% of analysts thought that at least sometimes spend on marketing should be given the same accounting treatment as technology R&D (Figure 14), which is capitalised with its impact on the profit and loss statement spread over several accounting periods.

Only 6% of respondents said marketing spend should not be capitalised. This suggests there would be strong support in the financial community for moves to review the accounting treatment of at least some marketing costs by moving them from opex to capex, i.e. treat brand building marketing budgets less like a series of short-term costs and more like longer-term investments in future business growth.

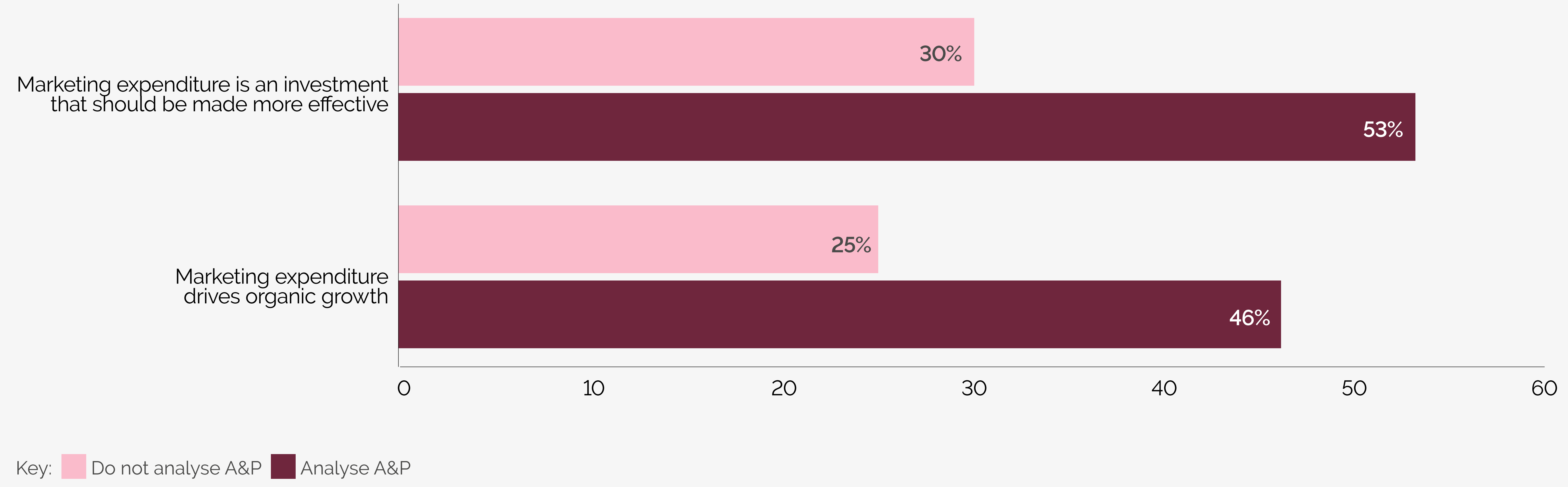
Analysts who did track companies' A&P were significantly more likely to view this spend as an investment and believe it could drive organic growth for the business (Figure 15).

Figure 14: Do you think marketing spend should be treated like technology R&D, where it is capitalised?



Source: Investment analysts research 2023 – IPA and Brand Finance   Total sample; Unweighted; base n = 203

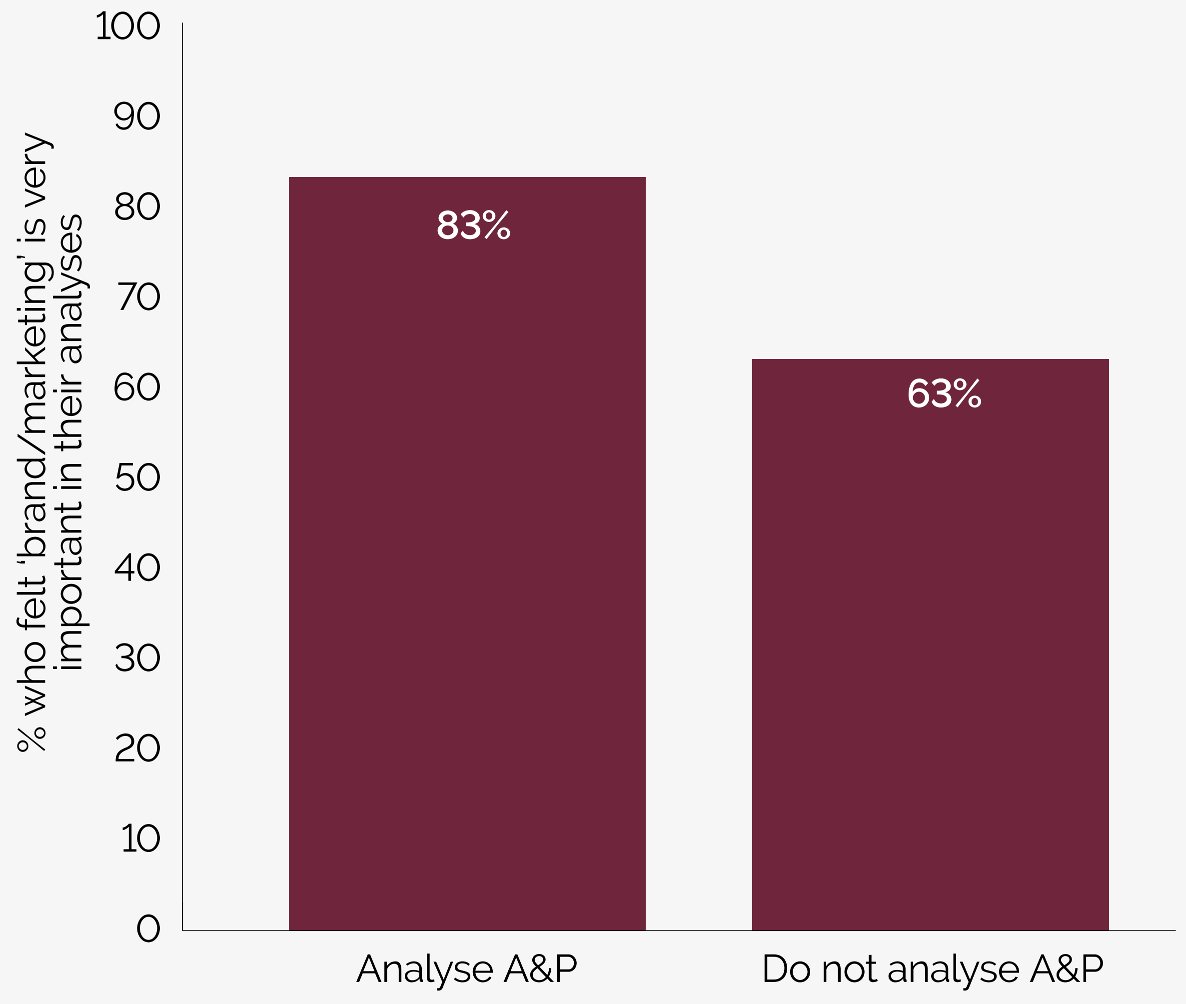
Figure 15: Analysts who analyse A&P are significantly more likely to believe it is an investment and that it drives organic growth



Source: Investment analysts research 2023 – IPA and Brand Finance   Total sample; Unweighted; base n = 203

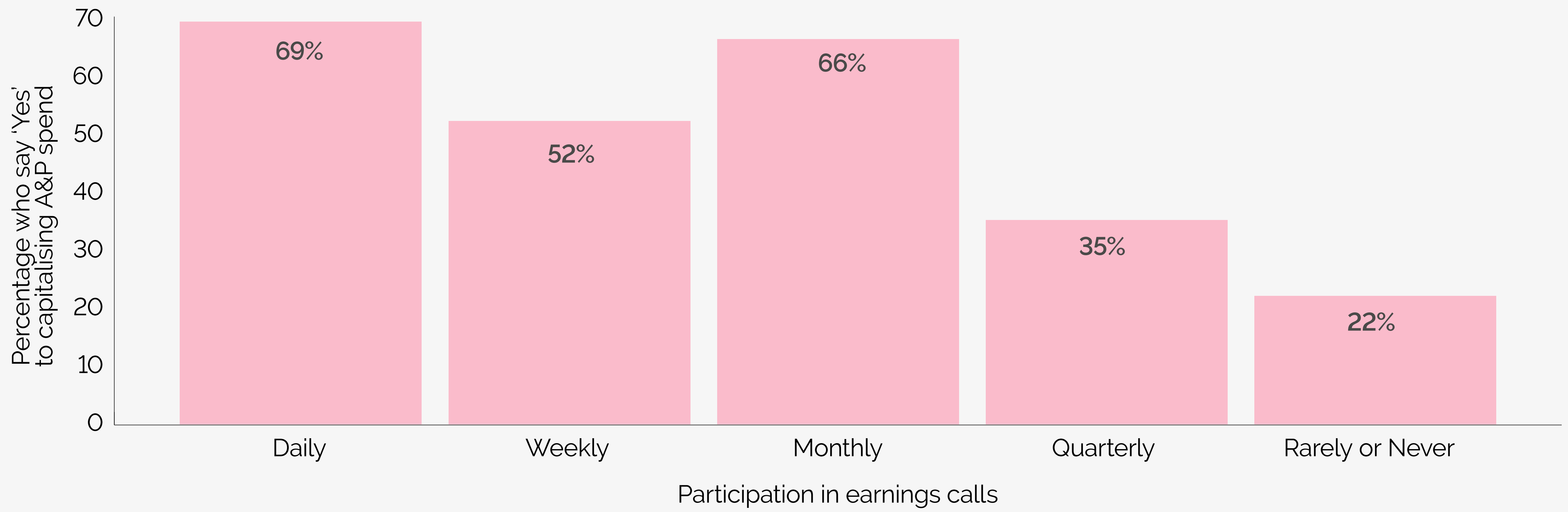
Three things stand out in the survey data. First, analysts who said they analysed A&P spend were much more likely to have a positive view of marketing as a contributor to organic growth and to believe marketing was an investment that should be made more effective. If marketers want to encourage analysts to think of their work as investing the company's money, and not just spending it, then they should provide analysts with more information and insights to encourage them to think of marketing strategies in this way.

Figure 16: Those who do analyse A&P are significantly more likely to believe that 'brand/marketing' is 'very important' in their analyses of companies



Source: Investment analysts research 2023 – IPA and Brand Finance Total sample; Unweighted; base n = 203

Figure 17: Those who participate more regularly in earnings calls are more likely to agree to capitalisation of marketing spend



Source: Investment analysts research 2023 – IPA and Brand Finance Total sample; Unweighted; base n = 203

Second, analysts who followed companies' A&P spend were also more likely to say that brand/marketing was very important to their analyses of companies (83% vs. 63%) (Figure 16).

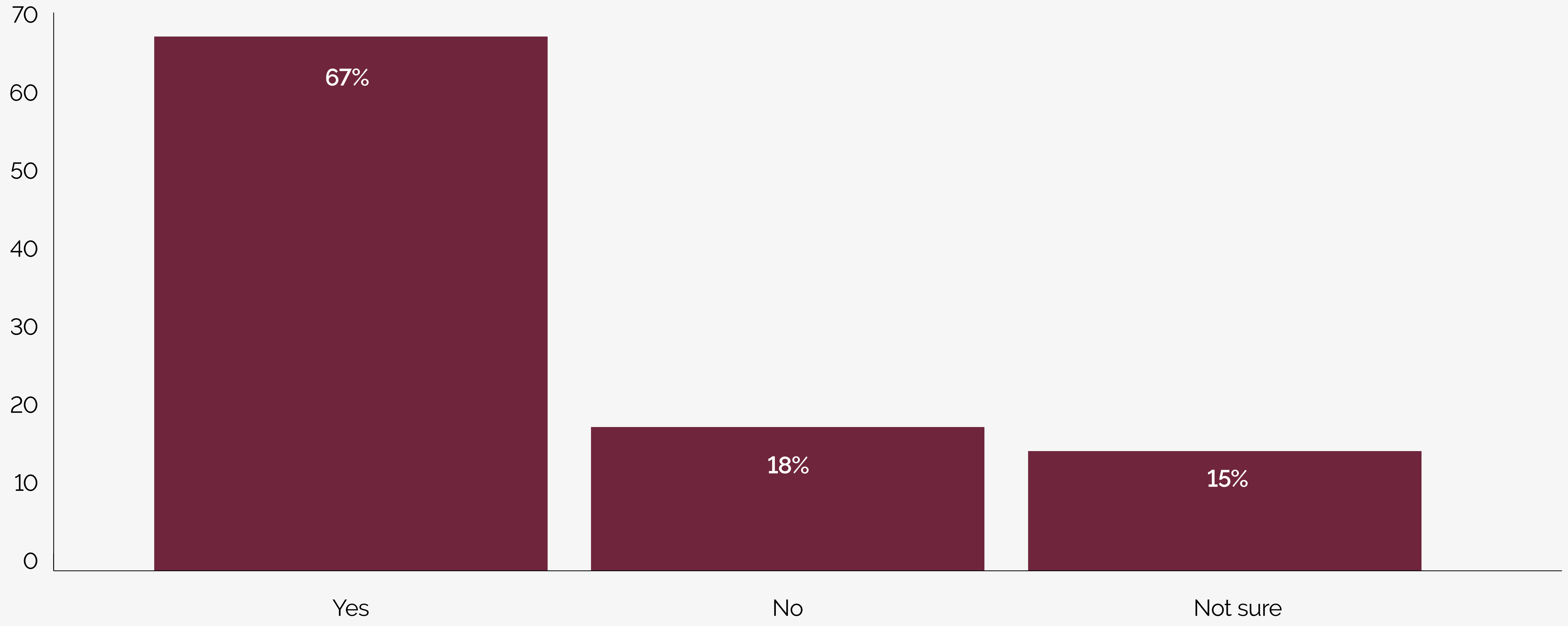
Third, those analysts that most frequently engaged with companies through earnings calls were the most likely to agree that A&P spend should be capitalised (Figure 17).

Taken together, these three findings suggest that if more businesses encouraged analysts to examine their A&P spend, and the companies themselves provided more information and insights on how this spend was contributing to the company's longer-term performance, attitudes could shift even further towards viewing marketing as an investment in the future growth of the business.

Over two thirds of analysts wanted to see changes to how intangible assets are reported on and accounted for

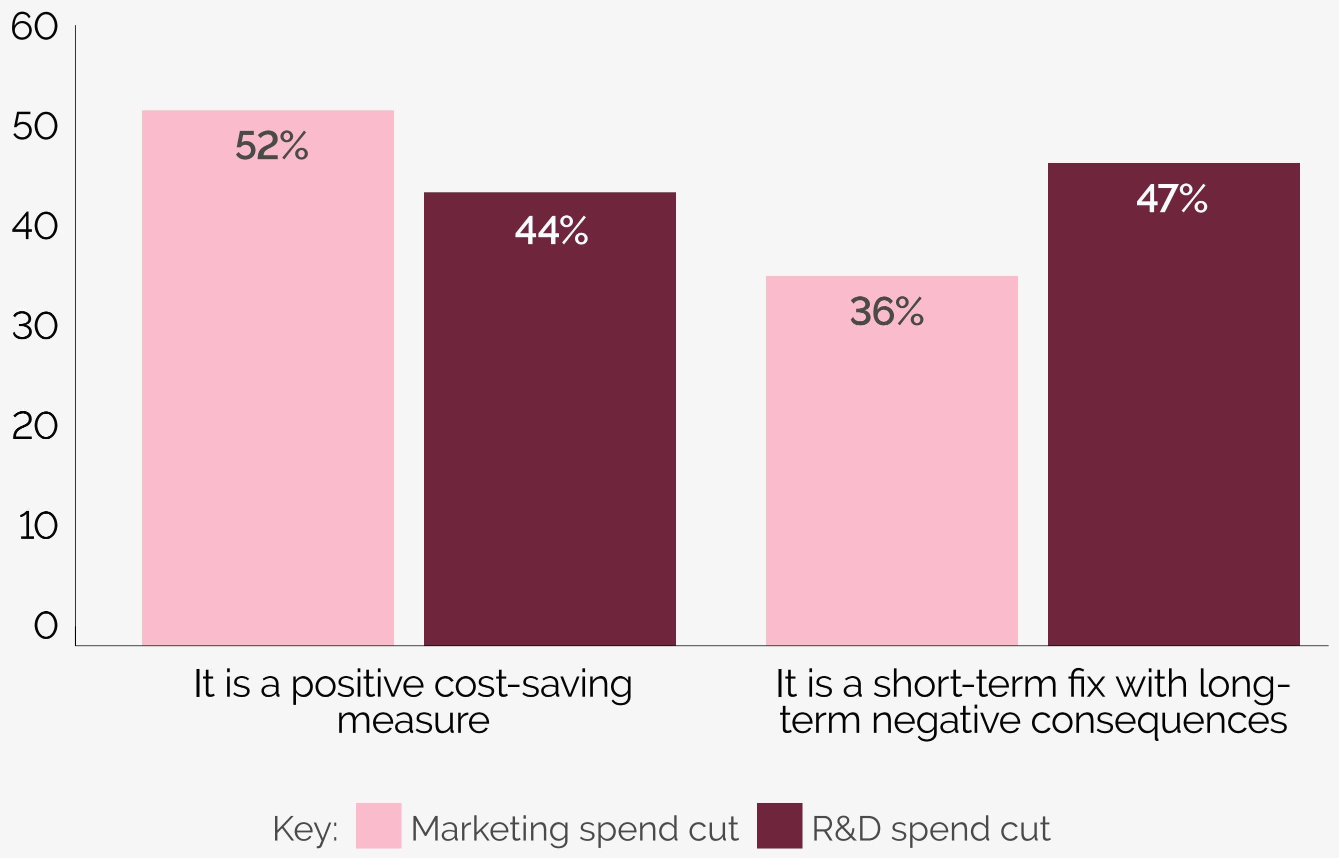
It should probably not be surprising that, given the interest in marketing expenditure, 67% of analysts also wanted to see changes in how intangible assets were accounted for, and reported on (Figure 18). As our previous findings show, as analysts' engagement with, and understanding of, companies' marketing grows, the perceived value created by marketing budgets can also increase. We discuss some ideas on how to improve communication, both within companies and externally, about corporate marketing strategies in part four of this report.

Figure 18: Thinking about the companies you cover, would you like to see a change in the way intangible assets are accounted for and reported on?



Source: Investment analysts research 2023 – IPA and Brand Finance Total sample; Unweighted; base n = 203

Figure 19: How is cutting marketing and R&D spend perceived?



Source: Investment analysts research 2023 – IPA and Brand Finance Total sample; Unweighted; base n = 203

There is more tolerance for cuts in marketing spend than there is for cutting R&D spend

We asked analysts how they would perceive an announcement of cuts to marketing spend from a company they were analysing. As shown in Figure 19, 52% of analysts saw cutting marketing spend as a positive cost saving and only 36% said they would regard a marketing cut as a short-term fix with negative longer-term consequences. Contrast this with the same audience's lower tolerance of cuts in R&D spend. For R&D, only 44% said they would view such a reduction as a positive saving and 47% would regard it as a short-term fix with negative long-term consequences (Figure 19).

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Elements of R&D spend are categorised as capex for accounting purposes, whereas we know that marketing expenditure is wholly treated as opex. For the reasons discussed earlier in this report, when companies need to make quick cuts that will impact their P&L, they will usually focus primarily on reducing their operating expenditure.

This might explain why analysts might prefer to see one of the companies they track cancel planned spend on marketing rather than on R&D. In addition, the link between spend on R&D projects and future growth opportunities for the business is well understood. Using the same justification that marketing spend is an investment in future growth is less common.

The marketing industry can help solve this knowledge gap

The advertising and marketing industries tend to focus their messaging on the danger of reducing marketing expenditure during recessions and other crises. Arguably, the case also needs to be made during more regular phases of the economy.

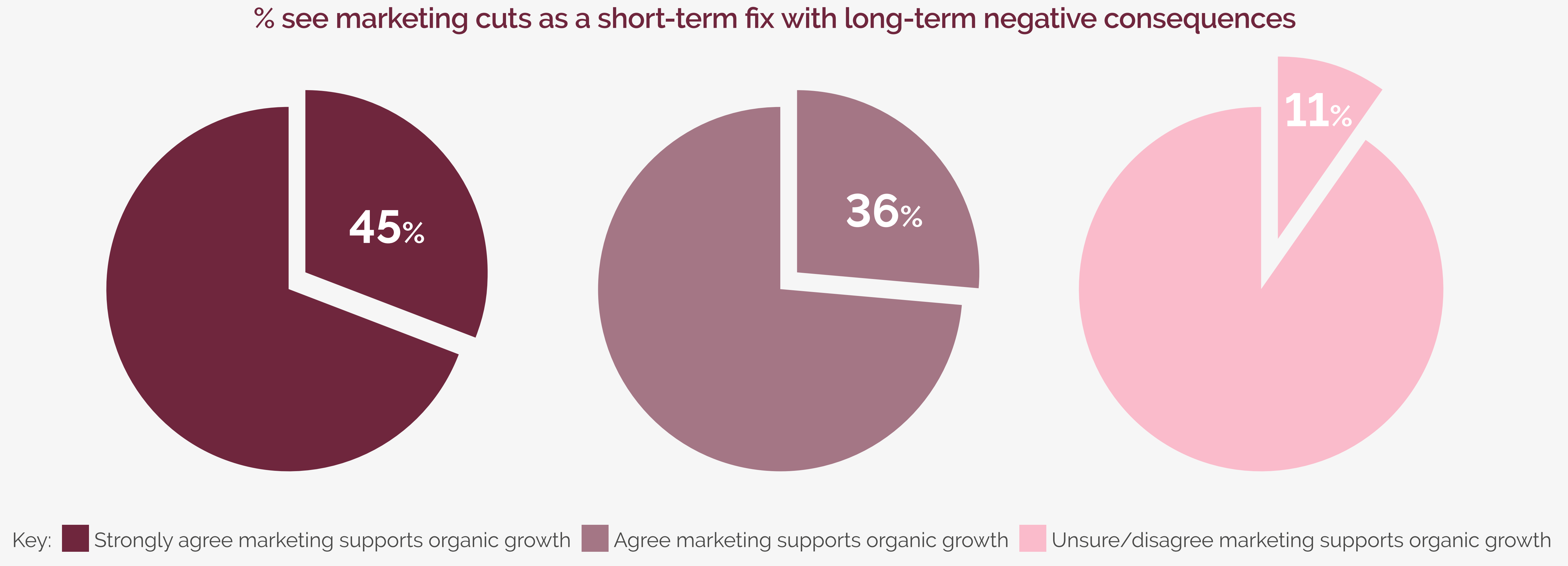
These industries can also educate the stock markets on the sustained, quantifiable financial contributions that effective brand building marketing can make to future sales, profit margins, and pricing power.

A company that can convincingly incorporate its use of marketing expenditure into its overall growth story to investors may enjoy benefits to the long-term performance of its share price. However, so many factors affect share price movement that it is hard to isolate the direct contribution of marketing.

The evidence from our analysts' survey is that the more that analysts examine and know about brands and marketing, the more supportive they are about marketing expenditure and the less likely they are to see marketing cuts as a positive move. But much more education is needed.

For example, analysts who strongly agreed that marketing supported organic growth were also the most likely to see a marketing cut negatively as a 'short-term fix with long-term negative consequences'. Among all those who 'strongly agreed' that marketing supports organic growth, 45% took this negative view of marketing cuts. As Figure 20 shows, this dropped to 36% among those who only 'agreed' that marketing supports organic growth, dropping down to 11% among all those who were either unsure about or disagreed with the link between marketing and organic growth.

Figure 20: Based on whether or not analysts agreed that marketing supports organic growth, their view of marketing cuts differed



Source: Investment analysts research 2023 – IPA and Brand Finance Total sample; Unweighted; base n = 203

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If marketing expenditure is to be regarded, at least in part, as an investment in future business growth, then the connection between how a business develops its brands through effective marketing and its organic revenue growth needs to be consistently and persuasively made clearer to analysts.

Some of our qualitative interviews provided further insights into why analysts could be relatively sanguine about reduced marketing budgets.

One analyst said cuts in marketing spend could provide a warning sign about the health of a company, particularly in high-end/luxury categories, but added that 'managements know best' when it comes to marketing spend, suggesting that managers could be reducing marketing spend for good reasons.

Another analyst said a marketing budget cut could be justified if there was evidence that a new product being marketed was not working or if the company believed that marketing funds were being spent inefficiently.

It is self-evident that some marketing projects are more effective and efficient than others. Given the evidence that many analysts believe marketing expenditure lacks transparency and robust metrics, it is perhaps not surprising they are accepting of spending cuts in this area.

Why don't more analysts prioritise marketing effectiveness?

When we asked analysts whether marketing expenditure on advertising and brand communications should be made more effective, answers varied.

We looked at how analysts answered this question of whether A&P should be made more effective based on how they answered the question of whether A&P should be treated as capital expenditure. Of all those who agreed A&P should be capitalised, 64% also thought this spend should be made more effective (Figure 21).

Among those who only 'somewhat agreed' with A&P being capitalised, disagreed or were neutral about capitalisation, less than 50% thought A&P should be made more effective.

One possible explanation for these views is that some analysts think that since a company's capital expenditure typically involves large investments in its long-term future, it needs to be spent as effectively as possible. If marketing spend were treated as capex and not opex, it should therefore be held more accountable for its effectiveness.

Conversely, where analysts don't support treating marketing as capex, they are probably more likely to think of marketing as primarily a cost to the business.

Figure 21

64%

of those who agreed A&P should be capitalised thought marketing expenditure was an investment that could be made more effective

According to this view, company leaders should focus on minimising the impact and cost of marketing on the business, rather than on putting too much effort into making marketing spend more effective.

The more that analysts are presented with stories and evidence that frame marketing expenditure as an investment that enhances profits or sales, the more they can be expected to want companies to optimise the effectiveness of this spend and to maintain it throughout economic cycles.

Next, we will look at some examples of large companies that have justified keeping up marketing spend by defending it as an investment that underpinned their ability to raise prices and increase profits, even in difficult conditions.

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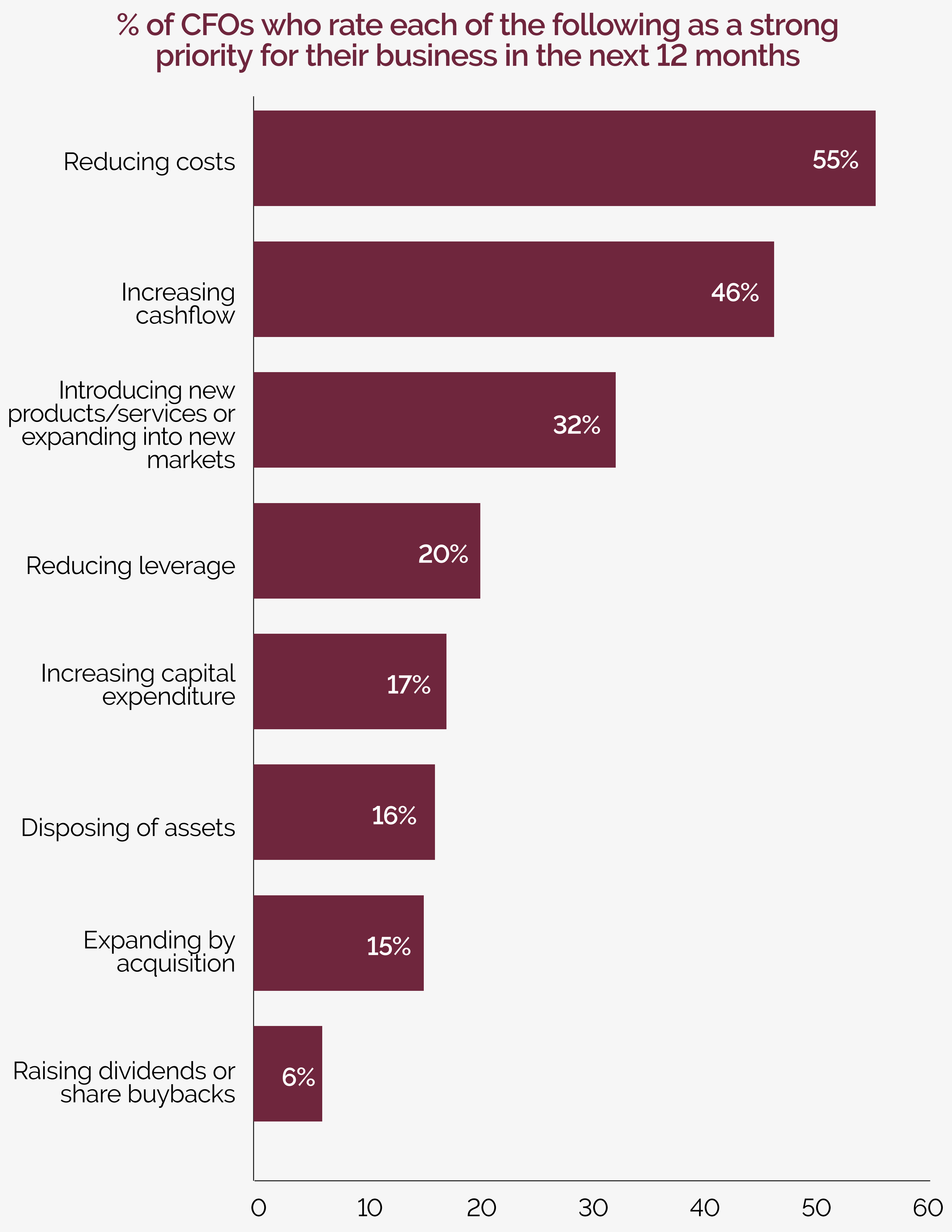
Part three:
Evidence from global brand owners on marketing, price and profit

When large companies present their business growth strategies to financial markets, they typically aim to explain both how their plans position the company to navigate the specific conditions in its category as well as trends in the wider economy.

In the post-COVID environment, these trends have included persistent inflationary pressures on the cost of energy, raw materials and labour, and high interest rates that make company debt more expensive to service.

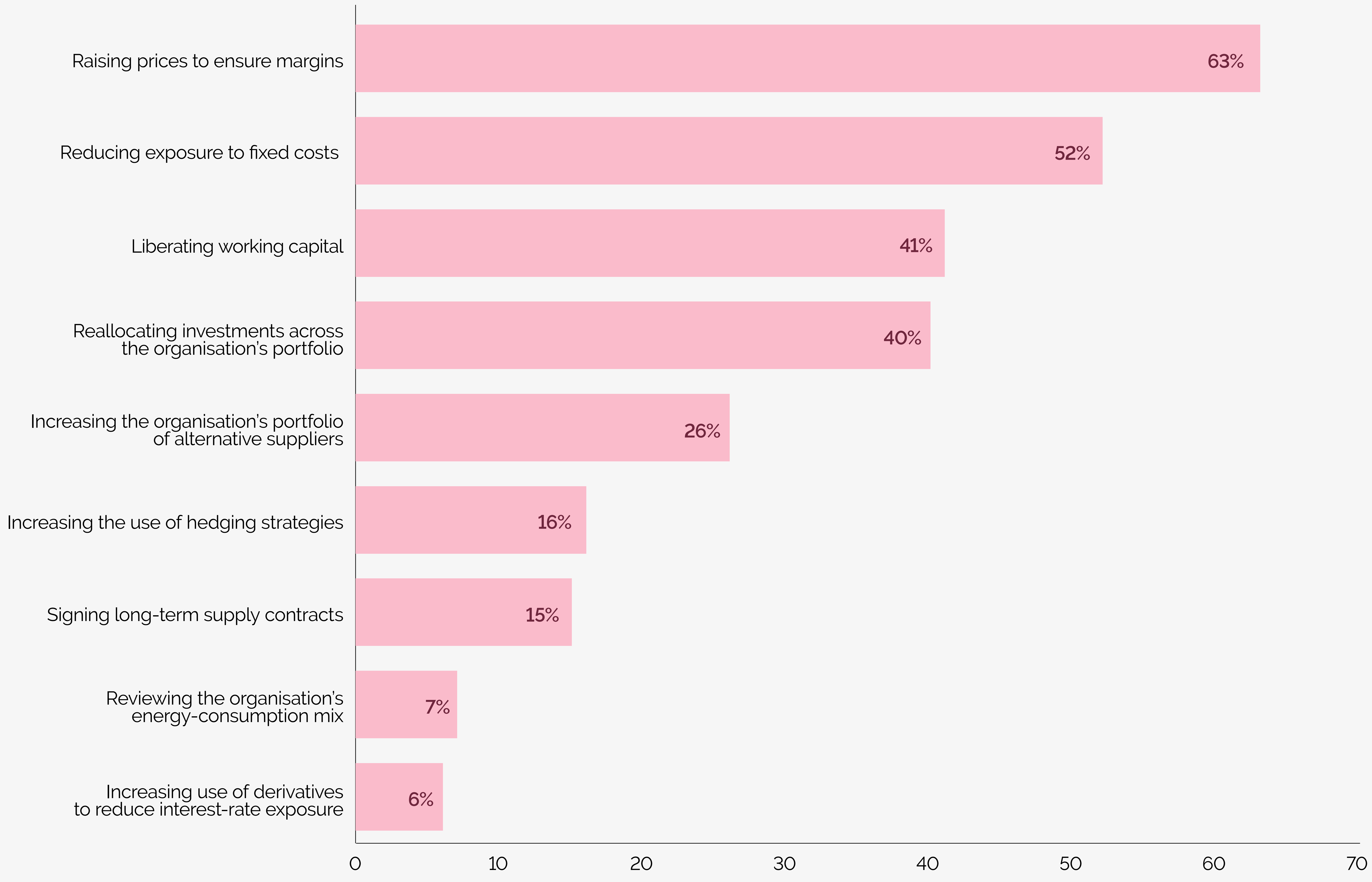
Unsurprisingly, polls such as the Deloitte UK CFO survey (Figure 22) have identified cost reduction as a priority for CFOs. To minimise the business risk from inflation, companies have sought, in addition to direct reduction of their costs, to increase prices to prevent input inflation from reducing profit margins. In the McKinsey Global CFO Survey 2023, interviewees saw increasing prices and reducing costs as by far the two most impactful strategies for navigating macroeconomic stability (see Figure 23 overleaf).

Figure 22: Corporate priorities in the next 12 months



Source: Deloitte UK CFO Survey Q2 2023

Figure 23: Companies' most impactful strategies for managing macroeconomic volatility*



Source: McKinsey. Global CFO Survey 2023
*Respondents were asked to rank up to three strategies, with one being the most impactful. Those who answered 'other' or 'don't know' are not shown

In theory at least, a price rise has a financial advantage over an increase in sales volumes because selling at a higher price should not add any extra cost to the company, whereas selling more units normally would involve extra costs. The main argument against price rises is that even a small increase in sales price will usually deter some buyers or make them switch to a rival supplier, and a significant loss in sales volume could wipe out the benefit in increasing the average selling price.

Based on sales data from many years, companies have models to predict a brand's price elasticity or the change in demand for the brand with any movement in its price (whether that is a price rise or a price cut).

What is interesting about the trend in recent financial results from major companies in the Consumer Packaged Goods (CPG) category, however, is that when businesses have put prices up, their sales volumes have tended to fall by less than expected by either the companies or their analysts.

When companies have been asked about this, they have often explained that the strength of the brands in their portfolio enabled them to make demand for their brands less elastic – or responsive – to price rises.

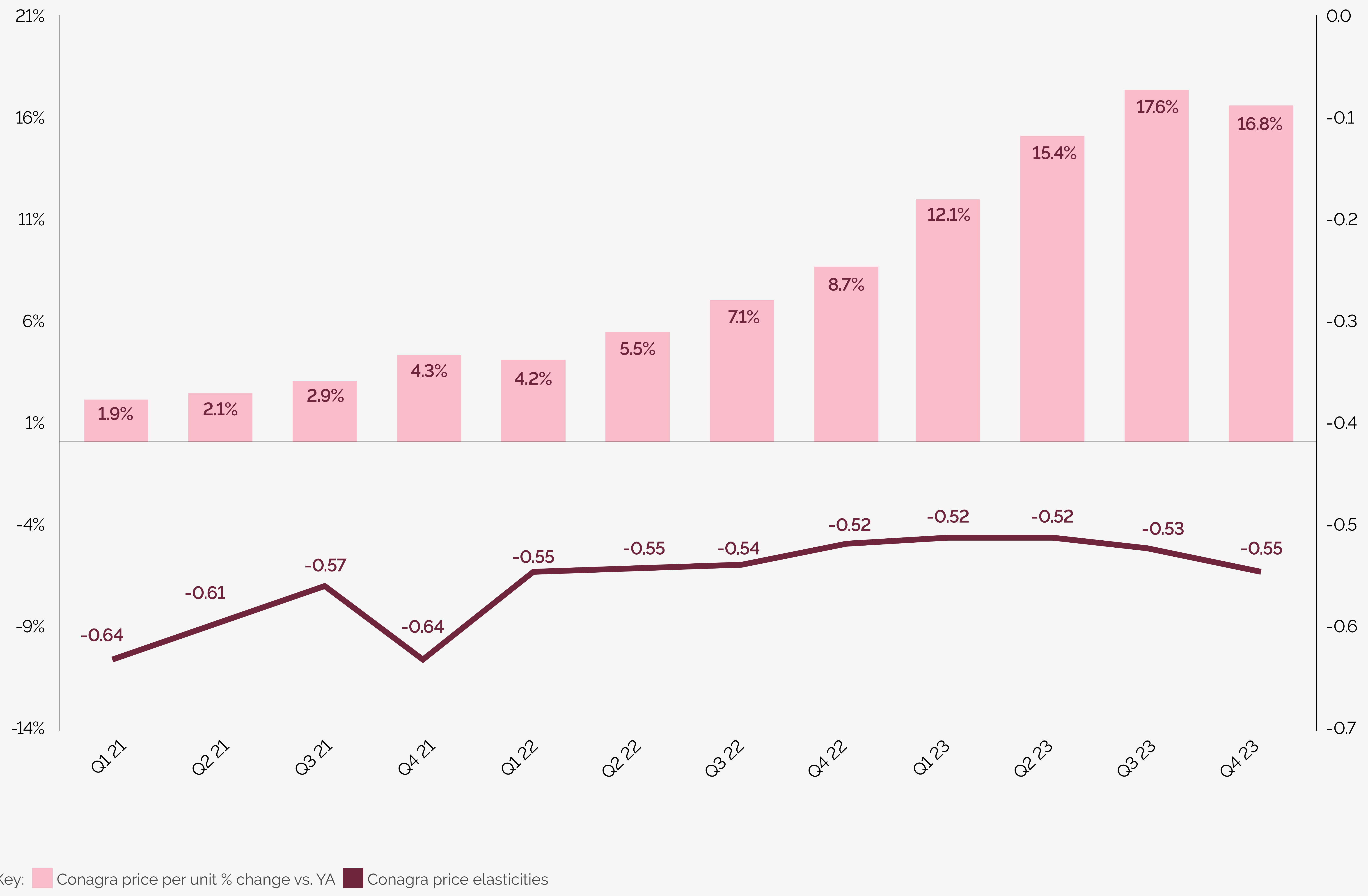
For instance, Figure 24 is a chart based on figures from Circana showing the relationship between the percentage changes in average price per unit and price elasticities at Conagra, the US owner of multiple brands in food categories such as cooking oil, frozen foods and hot dogs.

The chart shows that although the company made a series of double-digit average price increases over several quarters, its price elasticities remained basically the same, at least until the most recent quarter. It would have been reasonable to expect to see more significant movement in price elasticities.

This was not the only unexpected pattern seen in the financial results announced by CPG companies. Almost uniformly across the sector in Q2 2023, for instance, companies reported headline results ahead of market expectations. For example, Nestlé reported 8.7% organic revenue growth for Q2 vs. 8.1% predicted by the FactSet consensus of forecasts. PepsiCo delivered 13% organic revenue growth, ahead of the 10.3% predicted. Similarly, Danone, Unilever, P&G, and Coca-Cola all surpassed market forecasts.

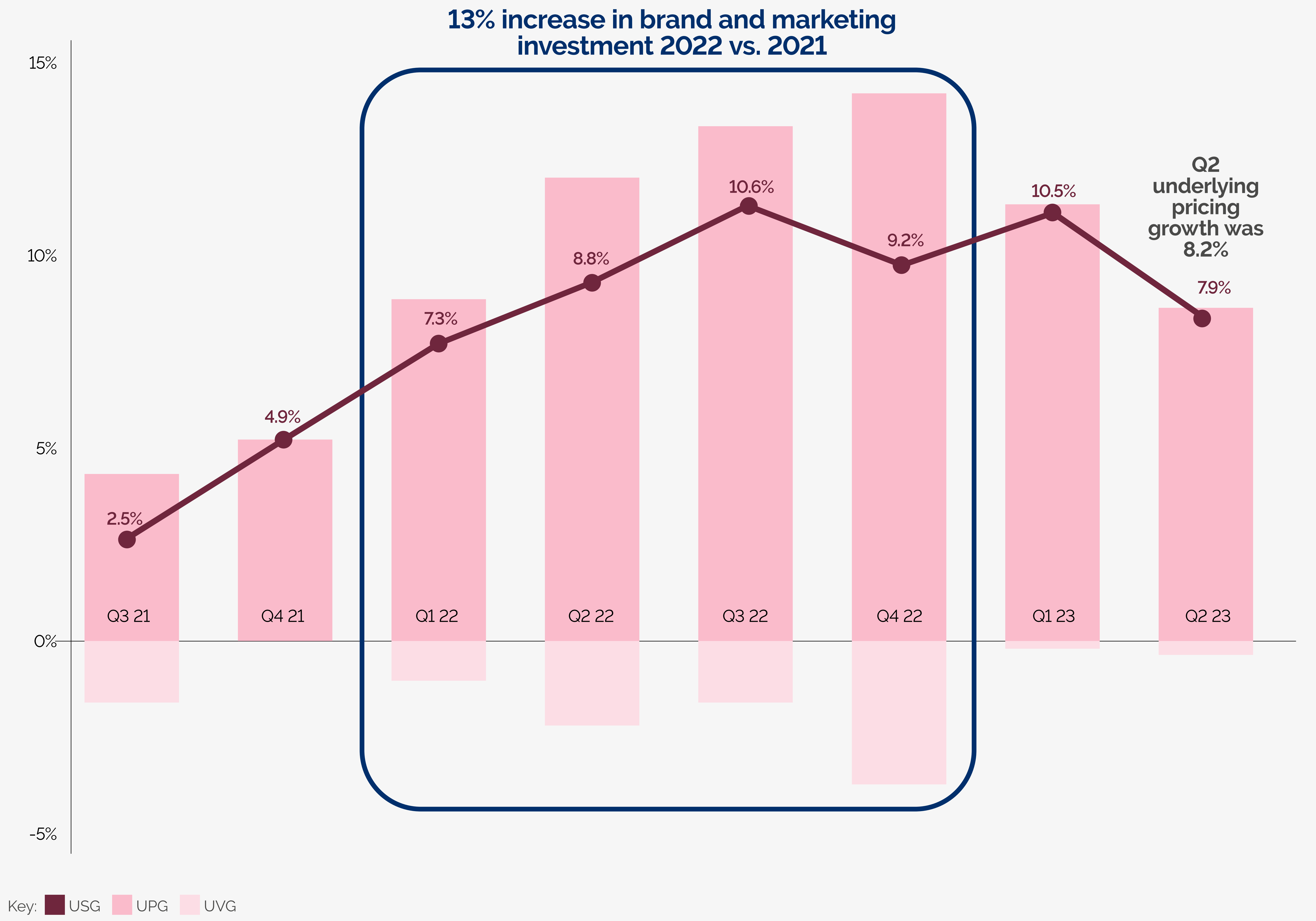
A key driver of these better-than-expected performances was the increased average price at which companies were able to sell goods.

Figure 24: Conagra's large price rises had little impact on its price elasticities



Source: Circana POS and Circana price elasticity, Total US-MULO+C, Edible xBeverage, Rolling 52-week periods ended 28 May 2023

Figure 25: Unilever net underlying sales growth (USG) = underlying pricing growth (UPG) + underlying volume growth (UVG)



Source: Adapted from company presentation

Figure 25 charts the change in underlying sales at Unilever during eight consecutive financial quarters. During much of the period shown, Unilever's growth in underlying price consistently more than offset small declines in sales volumes at the company to deliver an overall net growth in underlying sales. In Q2 2023 this pricing growth contributed to the company announcing financial results that beat its analysts' forecasts. Even allowing that inflation was driving pricing growth, one might have expected consumers to switch to lower-priced goods which would have resulted in bigger drops in sales volumes.

During much of the period where the chart shows Unilever reporting higher levels of price-led underlying sales growth, it had increased its spend on brand and marketing investment. In 2022, for instance, the company spent €7.8bn on brand and marketing investment – up from €6.9bn in the previous year. In autumn 2023, Unilever updated markets that it was on track to report another annual increase in full-year spend on brand and marketing for its 2023 financial year. For the first half of the 2023 financial year, Unilever said it had already spent an additional €400m year on year on brand and marketing investment. Any increase in marketing investment would take a while to have an effect so we will need further data to see the full impact on the group's performance.

These figures cannot suggest more than a potential correlation between increased brand and marketing investment and pricing-led growth at one group. By themselves, they cannot tell us whether other groups also increased prices by the same amount without increasing their marketing spend.

However, across the sector, there has been a similar pattern of companies reporting sales growth, led by price rises typically above inflation, and saying brand marketing investment contributed to their results.

Consequently, it has been common for CPG companies to raise their guidance for analysts and investors on what they think their full-year (FY) financial 2023 results are likely to be.

For example, Coca-Cola raised its FY organic revenue growth target from 7–8% to 8–9%. PepsiCo raised its top-line organic growth guidance from 8% to 10%. Colgate-Palmolive raised its forecasts from 4–6% to 5–7%.

These may not sound like dramatic rises unless we remember the size of the companies involved. Also, guidance in this sector has tended to be on the conservative side and it may be that, when full-year results are published, even these raised guidance figures may prove to have been under-estimates.

"Whenever you have a very strong brand with very strong benefits, consumers tend to be very loyal and follow those brands."

Danone

When asked to explain their ability to increase prices without experiencing predicted declines in sales volumes, several companies have said the competitive strength of their brands, supported by marketing spend, enabled them to raise prices without losing too many sales.

Danone explained: "Whenever you have a very strong brand with very strong benefits, consumers tend to be very loyal and follow those brands."

Coca-Cola said: "Our recipe for success is unchanged. We continue to deliver on our strategy through a combination of world class marketing and innovation, excellence in revenue growth management and strong execution."

Virtually, all the players in this space announced increases in marketing spend. Nestlé said it would increase its marketing as a percentage of sales by 100 basis points (i.e. 1%) in H2 23. For instance, Colgate-Palmolive grew A&P spend 20% in Q2 and by 17% in H1, and PepsiCo also said it had already grown its marketing spend by double digits.

How does this performance translate into extra profits in the long term?

First, we should be aware that small percentage increases in earnings can mean hundreds of millions in extra profit at companies of this size. As a theoretical exercise, and not a piece of investment advice, we could look at PepsiCo. In 2022, PepsiCo generated $86.4bn of revenues. On this basis, if it grew its organic revenues in the following year by 10% organic revenue growth, rather than its previous guidance of 8%, the company would generate an extra $1.7bn of revenue. If 30% of this revenue translated into profit, that would mean the company made an additional $518m of operating profit.

"Our recipe for success is unchanged. We continue to deliver on our strategy through a combination of world-class marketing and innovation, excellence in revenue-growth management and strong execution."

Coca-Cola

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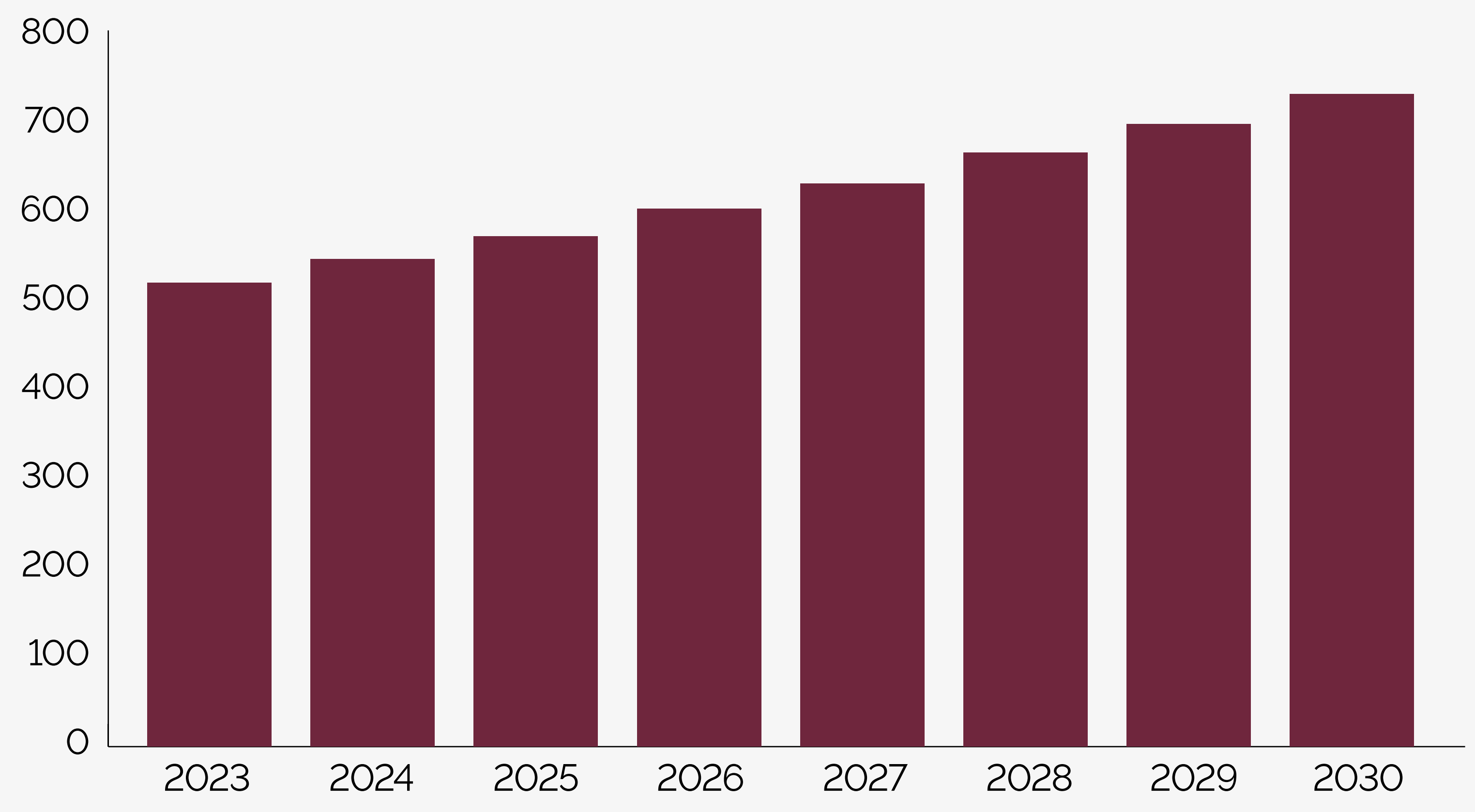
Again, in theory, if much of this additional revenue was due to the company's ability to raise prices without losing disproportionate sales volumes, it could be argued that the company would have a better chance of sustaining this level of revenue in future. This view is based on the argument that if consumers didn't baulk at paying the increased price in the short term, they would be less likely do so once they became accustomed to the new price. By contrast, companies often generate short-lived increases in sales volumes by offering time-limited price discounts or other promotions. But these promotions either simply displace sales that would have happened at full price anyway or bring in temporary buyers that will leave when the promotion ends – and they erode profit margins in the process.[6]

Even if a company only experiences one significant step up in its annual revenue and then reverts to a steadier annual growth rate, then the fact it would be growing from a higher revenue base can translate into a significant amount of extra profit by the end of the period in question.

Figure 26, for instance, has a theoretical chart about potential future operating profit levels at PepsiCo (purely to illustrate this hypothesis not as a piece of investment advice). It is based on the premise that PepsiCo generated 10% of organic revenue in 2023 and 5% for every year afterwards until 2030. It shows the extra operating profit this would translate to over the period at PepsiCo, compared with if the company only generated 8% organic revenue in 2023 and 5% annually for the rest of the period. Although the company's growth rate only differed in one of these years, over the total period the scenario with 10% revenue would generate about an extra $5bn of operating profits for the company.

Figure 26: Hypothetical PepsiCo 2023 extra operating profit from 10% organic revenue growth vs. 8%, at a 30% drop-through rate of revenues to profits ($m)



This theoretical exercise isn't meant to illustrate that it is easy to generate revenue growth at large companies. It is meant to illustrate the importance of compound effects on company profitability; compound effects are also relevant to understanding how effective marketing works.

Consistency is the key to achieving compound effects

In their communications to analysts and investors about their financial results, several of the CPG companies previously discussed underlined the importance of putting sustained, consistent funding into marketing to support brands in their portfolios.

When Procter & Gamble was asked on one of its conference calls about the correlation between the company's increased marketing spend and increases in its market share, the company representative said:

> **"It's not instantaneous... We have categories where the purchase cycle is once every six months or once every year, even. And so, we look at it (i.e. the impact of increased marketing investment on market share) obviously over longer periods of time."**
>
> *Procter & Gamble*

Asked specifically about its investment in advertising, a Colgate-Palmolive spokesperson said: "Advertising doesn't respond immediately. It takes quarters after quarters of consistent growth... And that's clearly the strategy because, over the long term, consistent levels of advertising play out for brands the best."

These comments allude to a truth about effective marketing that is obscured when businesses think of marketing purely as a short-term cost to be managed within one accounting period and not as a longer-term investment in the future growth of the business.

That truth is that sustained spend on consistently effective marketing does not produce one simple additive effect, but a variety of effects that can accumulate over time to provide compound benefits for the marketer.

These effects typically include several or all of the following:

- creating more awareness of and desire for the brand
- attracting new customers directly or indirectly by winning new distributors
- extending the brand into new categories
- and/or persuading buyers that the brand is worth purchasing at a higher price

Each of these effects is contributing to the potential reach and revenue base of the brand. Case studies and research reports published by the IPA and other bodies have shown that these marketing-created effects can extend over several years, with much of their value coming in the years after the marketing first ran.[7]

Over time, effective marketing also helps to build the overall valuation of brand assets. This brand valuation will be made explicit if those brand assets are later sold to another business, since the value of the acquired brands will be accounted for as assets on the purchaser's balance sheet.

The flipside of the belief in the potential compound effects of marketing expenditure on business growth is that any interruption in marketing spend may not just have a negative impact on growth in the period in which the interruption occurs, but on its longer-term base of revenue.

Even if the spending cuts were restored in future years, and the company growth rate recovered, it would be growing from a smaller base than if it had not missed out on those extra basis points of growth.

Obviously this is a moot point for anyone who thinks that marketing expenditure is either lacking in transparency or does not directly contribute to financial metrics, such as the company's sales price or total revenues. If they don't understand how effective marketing works, or even believe it can work to improve financial metrics, they are hardly likely to believe that it will work cumulatively.

However, from the remarks by Colgate-Palmolive and P&G quoted above, it seems that these companies do think of their marketing expenditure as a sustained investment aimed at delivering compound effects over a period of time.

This might be because, as the owners of big brands, these companies have already seen first-hand evidence of this compound effect in action. According to a recent presentation at the IPA EffWorks Global 2023 conference, brand size is the biggest single potential multiplier of profitability in advertising. Having studied multiple sources of evidence, including case studies in the IPA Effectiveness Databank, this research concluded that one of the factors behind advertising campaigns that generated the highest returns was that they involved bigger brands.[8]

Certainly, another big brand owner convinced that marketing is an investment is Tesco. As Tesco CEO Ken Murphy said:

> **"I don't see marketing as a cost. I see it as an investment. We obviously challenge ourselves to optimise our marketing and make sure we get the best bang for our buck, but we don't see it as a cost line to save money from."**
>
> *Ken Murphy, CEO, Tesco*

Part four:

How to make a more persuasive case that marketing is an investment

In this final part, we will look at how the case for regarding marketing as a long-term investment can be better made to convince more people, including specific financial communities, such as corporate finance teams and accounting bodies.

We recommend that marketers act in five areas to make the case for marketing as investment more convincing.

- Share more widely with analysts evidence from their own companies and trusted industry sources about the longer-term financial benefits of effective brand building marketing.
- Be more consistent in demonstrating, internally and externally, how marketing addresses the strategic and financial priorities of businesses.
- Use different language to encourage marketing to be bracketed with other long-term investments by their company.
- Embrace a wider range of techniques to evaluate marketing investments than just ROI calculations.
- Continue the wider dialogue about reforming the accounting treatment of marketing expenditure and brands.

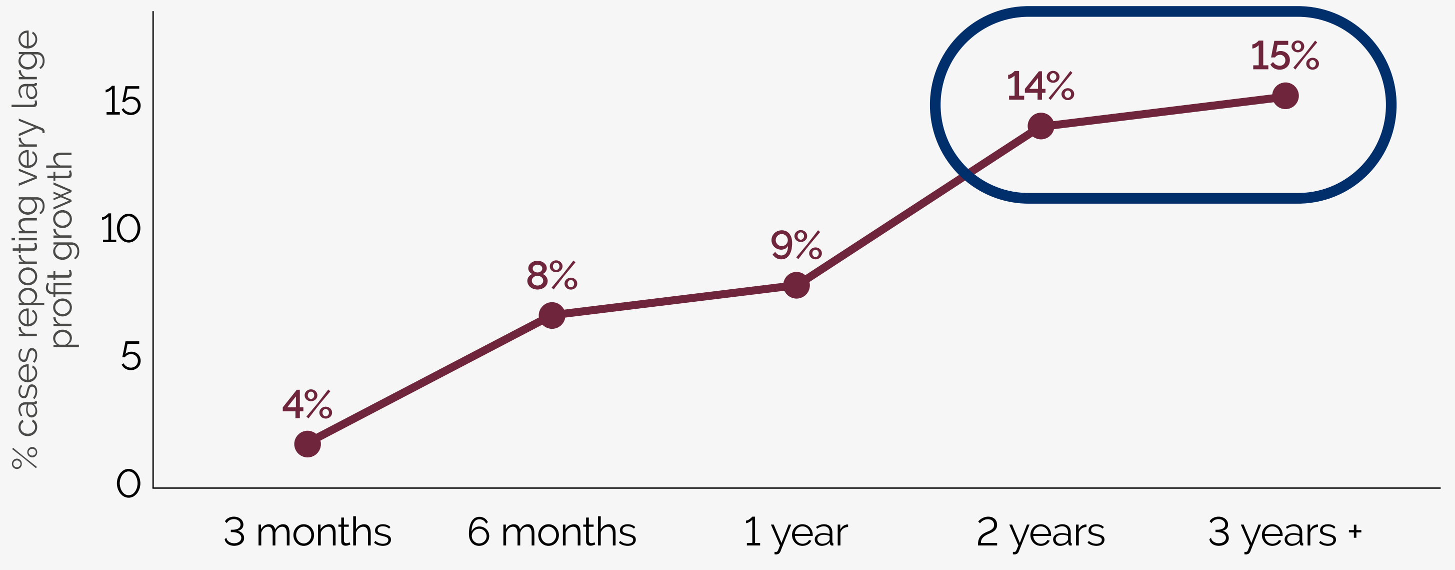
Evidence to support marketing as an investment exists but needs to be better known

The IPA publishes detailed evidence that spending on effective marketing can be an investment which delivers a variety of quantifiable improvements to key financial metrics over extended time periods. This evidence is contained in hundreds of rigorously proven case studies that have won prizes in the IPA Effectiveness Awards.

For more than 40 years these biennial awards have required entrants to show the financial value created by their marketing spend and to prove this value was not attributable to other factors. Organisations that have persuaded the awards judges that their marketing generated incremental financial gains over several years include – to name but a few – Tesco, Direct Line Group, Audi, Barclays Bank, Diageo, McDonald's, Mars Petcare, Specsavers and Cadbury (Mondelez). The fact that brand owners of this scale have put their names to published cases of effective marketing that ran over five or ten years, or in some instances even longer, should by itself provide benchmarks and arguments for anyone trying to encourage their organisations to view marketing in a longer-term perspective.

The data included in these individual cases is analysed in broader IPA reports. These aim to identify the common characteristics of the most effective cases, and to guide marketers in how

Figure 27: Longer-running ad campaigns are more likely to be very profitable



Source: *The Long and The Short of It*, IPA, 2013, and IPA Effectiveness Awards cases 1998-2010

to adapt these characteristics into successful strategies for their own organisations.

For example, the 2013 IPA report, *The Long and The Short of It*, found Effectiveness Awards cases running more than a year were more likely to report very large increases in profit than those running a year or less (Figure 27). The report argued that the best business outcomes were achieved by balancing short-term activation marketing with brand building marketing. Activation marketing is used to stimulate quick responses and immediate sales while brand marketing builds the fame, image and other values that over time foster demand, win more customers and enable a brand to charge higher prices.

If companies reduce spend on sustained marketing designed to enhance their brands, they risk missing out on the full potential gains from effective marketing.

The IPA cases and reports should be better known given that they are easily and cheaply available from its website. The annual EffWorks Global conference, run by the IPA, also provides an overview of new areas of evidence and best practice. Corporate marketers should also be encouraged to share their evidence of effective marketing in communications to analysts and investors. At the very least, wider knowledge of these resources could help tackle perceptions of a lack of transparency and credibility around marketing expenditure and marketing metrics.

Hannah Gillett, *Senior Communications Strategist,* Our LEGO Agency

Marketing must show how it addresses the financial and strategic priorities of the business

Since the most important audiences to sign off significant marketing expenditure will be the finance team, CEO, and the rest of the board, it is important that arguments for marketing expenditure speak to the financial and strategic priorities of these audiences and the metrics they value.

In the Deloitte survey of UK CFOs' priorities for the following year, the number one CFO priority (cited by 55% of respondents) was reducing costs. If the CFO's focus is on cost reduction, then an opex item such as marketing that appears relatively easy to cut is always going to be in the line of fire.

But the same survey signals opportunities for marketers to frame their budgets in other ways. The second and third priorities of CFOs were increasing cashflow (46%) and introducing new products/services or expanding into new markets (32%). If generating more cashflow is a pressing financial goal (when is it not?), then presenting solid evidence about the cash generated by past marketing programmes – when the marketing brought in new customers or supported a higher brand price point – could convince the CFO that the cash spent on marketing now and in the future will pay back in terms of more cash for the business within a reasonable timeframe.

Effective marketing can also help to open up new markets for the company. As an example, see the 2020 IPA Effectiveness Award-winning case study from Baileys, which showed it was marketing insight and communications, more than new product development, that enabled the cream liqueur to reposition itself worldwide as an all-year adult treat for younger consumers that was "part cake, part booze, pure pleasure".[9]

It is not always easy for marketers to stay on top of the changing priorities of finance chiefs and other members of the board, or to argue convincingly that marketing programmes are the best way of supporting these goals in a short timeframe. There may be no marketing representatives on the board, and marketers may not be part of the company's conversations with its investors and analysts. That can make it harder to understand some of the internal and external pressures and questioning that the company's leaders are facing.

What is within senior marketers' own power, however, is to ensure they follow the information that is available through the company's financial reports, presentations and conference calls.

It is even more important that a marketer is comfortable with the detail of the P&L and cashflow statements. Knowing the different profit margins on individual product lines or different distribution markets, or understanding how movements in interest rates, currencies or commodity prices can affect the company's overall finances, can explain why investments that seem attractive to a marketer may appear less so to a finance director. It may even turn up areas of cash cost and inefficient spend that could be saved or even redirected into the marketing budget.

Interest in the financial detail will probably not come naturally to marketers, but it is worth investing time in staying on top of the financial workings of the business if marketers are to show CFOs that they understand exactly how the company makes (and loses) money, and to convincingly demonstrate how what they do benefits the finances – and cutting marketing budgets would be a false economy.

The brute reality is that when a company is really struggling, many different parts of the business can be expected to make cuts, and marketing may not be able to avoid these entirely. The pressure will be on marketing to show it is a 'team player' and shoulder its share of the impact of cuts.

The more marketers are seen to understand the bigger picture at the business, and to communicate how their activities fit into it, the better position they will be in to argue for any cuts to be implemented sensitively and to make the case for restored marketing spend to be a key driver of recovery at the business.

Describe marketing in the language and terminology used for investment

Language matters. The words and terms used to describe marketing shape how it is, or is not, perceived, especially by non-marketers.

As we saw in the investment analyst survey, respondents divided between those who viewed marketing expenditure as primarily a cost or an investment and a significant number who thought it combined elements of both.

Words count. If a company says it is cutting costs, this will generally be seen as a positive development for its future profitability and competitiveness. If the same business says it is cutting investment, this is much more likely to be questioned, or even criticised, as limiting its future growth. The size of the cut discussed may involve exactly the same cash sum, but the exact word used would shape how it was viewed.

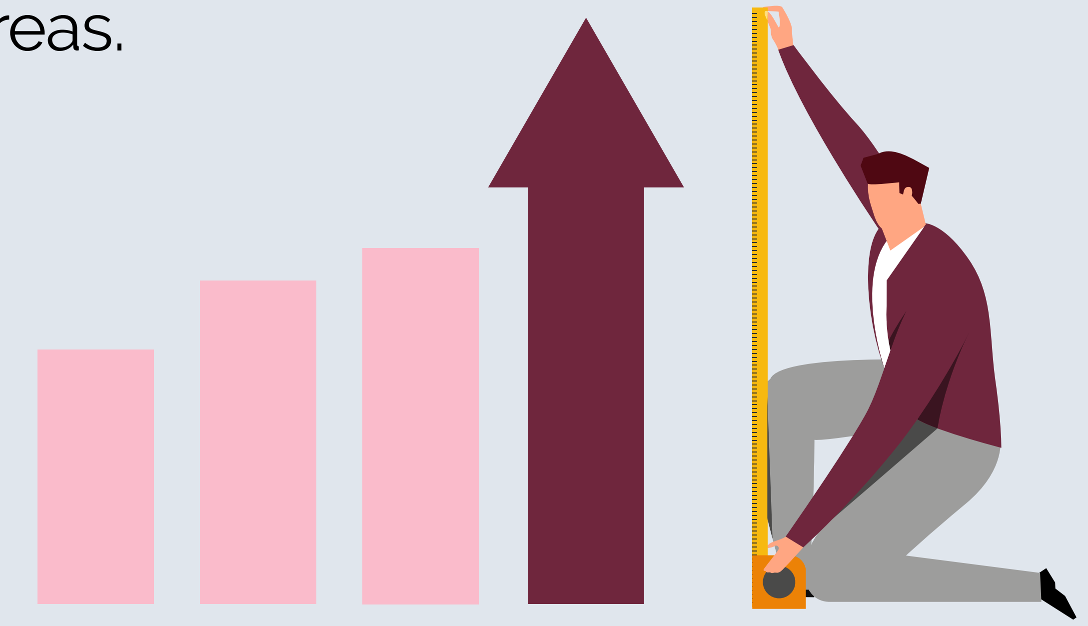
Thinking of marketing as purely a cost makes it easier to conceive of a marketing cut as a positive step for the business and downplays its potential longer-term negative impact.

But is marketing really a 'cost' on a company, in the same way that its electricity bill is a 'cost', when effective marketing can directly generate sales and contribute to the value of the company's brand assets, and its electricity supply cannot directly do either? The former can support future compound growth at the business, whereas the latter is merely a cost of being able to do business at all.

As explained below, accounting rules currently prevent companies from classifying marketing expenditure as capex on their financial reporting statements. However, there is no reason why in less formal contexts companies could not use a term such as 'intangible capex'[10] to describe marketing expenditure designed to build the company's brands into business assets of enduring value.

Groups such as Unilever already describe their marketing budgets as investment when they present their financial results to investors.

When it is the norm for companies to talk about investing in marketing and to adopt terms such as 'intangible capex', it should also be more customary to talk about the appropriate milestones and longer payback periods for some marketing investments, namely for brand building. It will also help marketers explain that, like all investments, there is some element of risk involved, but there are ways to evaluate and minimise this risk in marketing as in other areas.



Embrace a wider range of techniques to evaluate marketing investments than just ROI calculations

Many marketers will use return on investment (ROI) calculations to evaluate the financial payback from a piece of marketing expenditure. Typically the formula involves calculating incremental revenues or profits generated minus incremental costs from the extra sales, and then dividing this net number by the incremental marketing expenditure involved to give a ratio or percentage for the ROI.

Although ROI has its uses, this is not the predominant technique used by financial teams to evaluate investments. If marketers want to frame their budgets as essential areas of investment in the company's future growth, they should be prepared to use the techniques and language used by financiers, such as the discounted cashflow model (DCF) technique and net present value metric discussed below.

There are also some specific challenges related to ROI calculations.

First, ROI does not take into account the time value of money (the fact that money held today is worth more than the same sum held at a future date because of its earning potential in the interim). It is factoring in the time value of money, and how that money could have been alternatively used over a period, that enables DCF models to help companies evaluate the returns from the money invested compared to the payback that the company could have generated from putting that money to other uses.

Second, compared to DCF models, which are pretty standard, ROI can often be calculated in different ways by marketers. Sometimes the ROI stated is for revenue and sometimes it is for profit, and the calculation can be made over the whole period or in the form of annualised ROIs.

Third, and perhaps most seriously for champions of effective brand marketing, ROI calculations can encourage a bias towards the short term. ROI is a ratio of return to investment spend. Some forms of marketing, such as performance media, are designed to generate quick responses from existing buyers or people currently 'in the market' to buy the brand. Other marketing, such as brand building, can generate some quick sales but will primarily accumulate sales over a much longer period by building brand awareness, image or some other attribute amongst people not currently looking to buy the brand or who have never bought it. Effective marketers know how these different types of short-term and longer-term marketing work best in combination and try to balance them.

One danger of being over reliant on ROI to evaluate marketing expenditure is that it can make some short-term activities look as if they generate very high returns in a short period and can encourage companies to skew investment towards them. Yet, when marketing expenditure is fully evaluated and its impacts on sales attributed to different activities over a longer period, it may be that weighting spend towards consistent brand build marketing would have generated bigger financial gains, and that is what research studies from the IPA and others have consistently concluded.[11]

Since ROI is a ratio, it can also be manipulated by the level of investment involved. If the ROI data over a period seems to be showing that the returns from a marketing project have peaked or have fallen below a target figure, a company might decide to stop spending on it. However, although the ROI had dropped, that does not necessarily mean that the company would not profit, albeit at a lower rate, from continuing to invest. If it stopped spending based on the ROI data, it could actually end up with less net absolute profit than if it had kept funding the project.

Finally, ROI doesn't put a figure on the ongoing residual value created by the investment beyond the period covered. This is significant in our context if you believe that effective marketing adds to the value of a brand which can endure for many further years, or even decades.

Given these limitations, ROI does not tend to be used as a valuation metric within the investment community. Generally analysts use the DCF model, which captures future marginal cashflows, adjusted for the time value of money, over the period of the investment. It would then add in the sum of the discounted marginal cashflows from the period and subtract the investment cost to arrive at the net present value of these cashflows as a way of measuring the attractiveness of the investment.

There are several important factors in the methodology. The primary one is the weighted average cost of capital (WACC) rate, which is the rate at which future cashflows are discounted back by to reach their value today (so the longer out the cashflows are, the more they will be discounted back). The key input factor into the WACC rate is the risk-free rate, which is often the rate paid on US Government debt or the equivalent in major economies.

The second is what is called the terminal growth rate which is used to drive what is called the terminal value (TV). The terminal value captures the value created beyond what is called the explicit forecast period. Except in exceptional circumstances, most analysts only give explicit forecasts for five years, or seven years at most, though firms obviously generate value beyond that timeframe.

Figure 28 is an example of a DCF for a hypothetical new marketing campaign designed to run over several years. The investment is the marketing spend. The returns are improved sales. The net return is the investment minus the additional sales. The discount factor is the rate at which the returns are discounted back by using the WACC rate, which produces the discounted cashflows of the returns line (net returns x discount factor), and the sum of the cashflows is the sum of the five years' explicit forecasts. The returns beyond the explicit timeframe are captured in the terminal value, which is the terminal return based on the last year's explicit net return and adjusted for the perpetuity growth rate.

Figure 28: Hypothetical DCF calculation of marketing investment (£)

	Yr 1	Yr 2	Yr 3	Yr 4	Yr 5
Investment (marketing spending)	-100	-100	-100	-100	-100
Returns (improved sales)	25	75	150	250	375
Discount factor	100%	91%	83%	75%	68%
Net returns	-75	-25	50	150	275
Discounted cashflow of the returns	-75	-23	41	113	188
Sum of cashflows	244				
Growth in perpetuity	5%				
Terminal cashflow	289				
Terminal value	3,944				
Total value	4,189				

Source: IPA/Liberty Sky Advisors

In Figure 28, the total present value generated by the hypothetical spending of £100 a year indefinitely on marketing is £4,189. What the calculation also demonstrates is that, while the net returns are negative in the first two years, they turn more positive as time goes on and the compound effect of marketing spending becomes more pronounced.

There are a couple of main reasons why a DCF model makes more sense for evaluating returns from brand marketing than the current preference for ROI.

First, rather than provide an overall snapshot, as ROI does, a DCF shows the net present value of an investment which generates higher financial gains over the middle and end of the period and not at the beginning. This description typically fits the trajectory of brand building marketing.

Second, the terminal value puts a figure on the ongoing value created for the brand after the end of the period of marketing. To put this in context, if Coca-Cola suddenly stopped marketing, it would still see the continuing benefits of its previous marketing for years, if not decades, to come. A ROI calculation would not be able to estimate that value.

If marketing is treated as an investment, then its practitioners should be comfortable using techniques, such as DCF models, used to evaluate other types of investment.

Whatever models marketers use, they need to ensure that they can defend their assumptions and the forecasts behind the model. Focus on the inputs, not the outputs. Boards know models can easily be manipulated to suit a desired outcome, so they tend to focus on the quality of the inputs. No forecast will be 100% accurate but marketers should be able to show that it is based on sound assumptions, ideally developed in co-operation with finance and other parts of the company, and features the most up to date evidence.

Changing accounting rules on marketing would require a wider dialogue

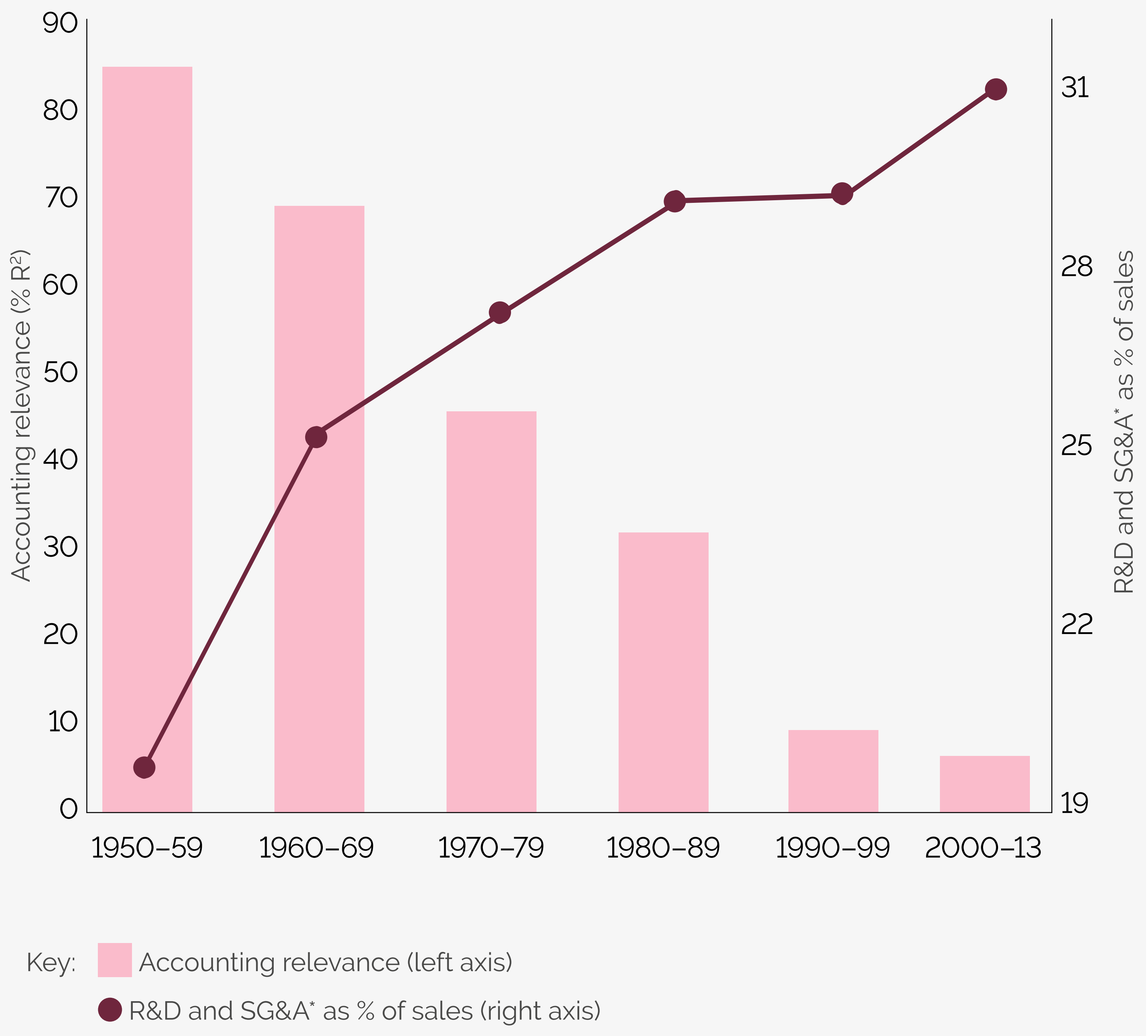
To observers it may seem strange that the relevant accounting standard (IAS 38 Intangible Assets) defines an intangible as a non-monetary asset without physical substance whose cost can be measured reliably and that generates future economic benefits. To many, this is a description that would seem to fit a brand.

But IAS 38 does not permit the capitalisation of advertising spend, mainly on the grounds that other factors, such as customer service, contribute to the building of brand equity so it can be hard to define the exact contribution of marketing. To capitalise long-term brand building marketing, this spend would need to be separated out from shorter-term marketing spend, which is not straightforward.

The international accounting standards (as set by the International Accounting Standards Board (IASB)) and the US accounting standards (as set by the Financial Accounting Standards Board or FASB)) say advertising must generally be expensed.

The IASB gives the reason cited above – namely, that it can be hard to separate out what exactly has contributed to the building of a brand. The rationale for the position taken by the FASB is more based on the belief that the future economic benefits of advertising cannot be reliably measured.

Figure 29: Decreasing accounting relevance by vintage year of public companies entering a US stock exchange



*SG&A = selling, general and administrative expenses – many intangible investments are included in SG&A
Source: *The End of Accounting – and the Path Forward for Investors and Managers* Baruch Lev and Feng Gu, 2016

However, there is a growing view that accounting standards are increasingly divorced from the reality that more of the value of modern companies is created by intangible assets, such as R&D projects, software and brands, than physical infrastructure.

See Figure 29, from the publication, *The End of Accounting* by Baruch Lev and Feng Gu, which argues that since the 1950s companies' financial statements have less reflected the real value of the business, as intangible investments have risen in importance.

Nevertheless, industry standards that have been used by millions of businesses and accounting practitioners in multiple territories for decades are not easily changed. To do so usually requires detailed consultations, time and confidence building to engage with a variety of interested parties in different territories to work through the practical implications of how any changes would be applied and their impact.

Just to take the more obvious questions, if some marketing expenditures were to be capitalised and some continued to be expensed, what would be the criteria for separating marketing spend for these reasons? As capex is investment for assets with an agreed value, what would be the agreed methodology for companies to value capitalised brand building expenditure? How would brand owners account for this via amortisation policies?

Getting the accounting treatment of marketing and brands changed is a marathon, not a sprint. Yet many of the negative or ambivalent perceptions about marketing expenditure can be tackled without accounting rules being changed. The first step would be to increase information-sharing about marketing between companies and their analysts and investors. However, if the rules were revamped as part of broader efforts to frame brand building marketing as long-term business investment, the race will have been worth running.

Appendix

Appendix

An explanation of depreciation and amortisation costs, and how they are treated from an accounting standpoint

What are depreciation and amortisation (D&A) costs? These relate to the write down in value for either tangible assets, such as buildings (depreciation), or intangible assets, such as software (amortisation). Typically, an asset will have a 'life' of a set number of years before it needs to be replaced, which will vary by the type of asset.

Usually, assets are depreciated or amortised using the 'straight line' method i.e. the depreciation/amortisation cost is the same for each year. For example, if an asset costs £10m and has a life of 10 years, then the annual depreciation/amortisation charge will be £1m per annum. There are exceptions to this rule. For example, with television and film content the costs are usually heavily amortised upfront, i.e. in the early years, as that is where most value will be generated, namely when the film/programme is first shown.

Where depreciation and amortisation costs fall in the balance sheet is related to capex and opex. When it comes to capex, there are three key differences as to its treatment versus opex.

First, capex goes straight to the balance sheet as an asset (it will also impact the cashflow statement) and will only impact profits in future years. Software costs, for example, are typically capitalised and then their amortisation cost is written down over several years.

Second, when it is recognised as a cost through the P&L, it comes through the depreciation and amortisation line. That matters because one important financial metric that analysts and investors focus on is EBITDA (earnings before interest, tax, depreciation and amortisation), which is commonly used as a measure of underlying profit. Such D&A charges thus do not impact the EBITDA number. Therefore, if any marketing costs were shifted to capex, and would appear on the P&L as amortisation charges, the company would be likely to show a higher EBITDA (because the profit was counted before adding in amortisation).

Third, investments are not fully depreciated over one year but over a period of time depending on the asset. A factory, for instance, may be seen to have a 'life' of 25 years, which means that 1/25th of its value will be depreciated every year. In effect, it means that the P&L cost (if not the cash one) of investments is spread out over a number of years. If a brand owner spent £10m on an advertising campaign, under current rules it would represent £10m of expense in one year. If rules changed, and it could be demonstrated that advertising delivered value over five years or more, then instead of a £10m one-year expense, the company's P&L could simply include a £2m amortisation charge in the first year, resulting in an £8m improvement to its reported profit or loss for that period.

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Endnotes

1. For evidence of the impact of marketing budget cuts during the COVID pandemic, see Eff Works 2022.
2. *The Board-Brand Rift*, IPA, 2019.
3. 'Chief executives really need to lengthen their attention spans', *Financial Times*, 4 October 2023 (subscription required).
4. For evidence of how share of voice in advertising contributes to pricing power see 'Brand power in an inflationary market', Eff Works Global 2023.
5. To compare answers to this question in the 2005 and 2023 surveys, we extracted responses from the UK-based respondents in 2023.
6. See analysis of promotions in *'Marketing in the post-COVID economy'* presentation, Eff Works Global 2022 conference.
7. For evidence that long-running campaigns are more likely to be effective, see *The Long and The Short of It*, IPA, 2013, and other IPA reports.
8. For evidence that brand size is a driver of profitability in advertising campaigns, see 'Managing for creative effectiveness' presentation, Eff Works Global 2023.
9. See 'Baileys: The pleasure dividend', IPA Effectiveness Awards 2022 case.
10. 'Advertising as intangible capex'™ is a trademark of Liberty Sky Advisors.
11. For evidence that the most effective business outcomes from marketing are produced when spend is weighted towards brand building, see *Effectiveness in Context*, IPA, 2019.

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