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A Word of Warning Clarified: Reactions to Peppers and Rogers' Response

Tim Ambler and John Roberts

Multiple measures are needed to describe the multiple, partially independent, and critical dimensions of marketing activity. As Einstein said, "Everything should be made as simple as possible, but not simpler."

We are grateful to Peppers and Rogers for their splendidly robust comments on our paper. It is extremely helpful to see the areas that need clarification and those that are in contention. Rather than attempt a point-by-point rebuttal, we will address the main areas of difference and/or confusion, and will leave final judgment to the reader.

1. To paraphrase Peppers' and Rogers' question: Why do Ambler and Roberts steer clear of the "silver definition"?

We didn't. We would like there to be a silver metric too, which is why we went to such trouble to see if they worked. We examined the main measures that have been advanced as silver metrics. We consider it important to understand what we can learn (and, more importantly, what we can not learn) from such magnificent promises as "the one number you need to know to grow" (Reichheld 2001).

2. Although, Peppers and Rogers contend otherwise, we are not against the use of DCF techniques.

In the specific case of Peppers and Rogers' Return on Customer (ROC), we tried to make it clear that we regard customer-level analysis traced through to its impact on the firm's financial performance as an insightful way to understand marketing value creation. We were not arguing against it nor against the use of DCF analysis to decide the allocation of limited resources. We agree with that. We also agree with the theory that value creation in any period is the sum of the net economic rents from customers in that period plus the increase of customer lifetime value, or customer equity, since the beginning of the period. That is not to say (see below) that cash in hand is interchangeable with discounted future cash flows. The point that we are making both conceptually and mathematically is that forecasting accuracy and management performance are hopelessly confounded in the ROC equation, making it impossible to attribute increased Return on Customer to excellent management performance or to a lack in ambition in forecasting.

Peppers and Rogers give the example of a Verizon-Vodaphone subsidiary providing very impressive growth rates in the customer base and reduction in churn. They compare customer equity at the end of the three-year period with that at the beginning. Commonsensically, they are right to draw attention to the huge improvement in the business situation over the three-year period. The customer value increase from $330 at the beginning to $540 at the end of the accounting period is presumably based on projecting the recent data. We are not told but this is common practice. There is the world of difference between a mechanical projection of current data and an objective forecast of future performance. This is one of the points we have been making.

An accurate forecast at the beginning of the period would have anticipated both any change in the competitive context and the business improvement during the period. The improvements should have been planned and therefore forecast. In that case, the change in customer lifetime value would have been forecasted and ROC would have been zero. Should management take credit for unplanned improvements? The Peppers and Rogers' formula is a logical muddle because of the different views of the future they try to build into the assessment of past performance. In particular, the firm's real performance, competitive context, and forecasting performance are confounded. A positive ROC may be due to unplanned performance, or changes in the competitive environment, or variances in forecasts, or any combination of the above.

3. Our discussion of Peppers and Rogers' reliance on forecasts

We cannot measure the future, only forecast it, and, as our paper points out, those forecasts are full of traps. In evaluating past performance, we should not take credit for future marketing decisions. Using Return on Customer and DCF techniques requires exactly that. Poor performance may engender drastic action [sacking the CMO] that would not otherwise have taken place. The forecasters in the Peppers and Rogers' scenario would have allowed for that so the performance would have seemed rather good, and the CMO would not have been sacked while the performance in real terms continued downhill. But since in this world forecasts are not wrong, the forecast would have allowed for the recognition of the unreality of the alternative forecast and the CMO would have been sacked after all. But then….

Any resemblance of this world to Alice in Wonderland is not entirely coincidence. Which forecast would you like?

4. "Indeed, the whole discipline of economics is based on the straightforward and commonsense principle that cash expected to be received in a future period can *always* be equated to some amount of cash held currently, by applying an appropriate discounting function of one kind or another."

Adam Smith may be surprised by that statement from Peppers and Rogers' comments. Any bank manager can tell you that cash in hand is not the same as promised future cash, however discounted. This problem with tenses lies at the heart of the Peppers and Rogers' confusion. We entirely agree that DCF techniques are valuable for future activities such as determining strategies and plans but we are talking of evaluating past marketing performance. We also agree that cash is the ultimate measure of marketing performance but we are never at this ultimate point. In assessing performance we have to look at two things: cash flow to date and how recent performance has enhanced future prospects. We think Peppers and Rogers agree with that.

Where we part company is whether DCF techniques are valid for the latter part of that analysis. That has been conventionally assumed but the value of our paper lies in challenging that assumption on the grounds we set out and will not repeat here. But the essence is one of tense: DCF is forward-looking and good for that purpose. It takes all future actions into account, or should do so. Performance evaluation is backward looking and only considers the outcomes from past actions. So we look at cash flow and the brand equity enhancement to date. We have to measure those with today's numbers, not speculation about the future.

5. Marketing must talk to financial executives and they do not want multiple measures.

We are sorry that Peppers and Rogers feel the need to tell us to "get real." To believe that multiple measures are needed to describe multiple, partially independent, and critical dimensions is not unreal. We have an immense admiration of simplicity but as Albert Einstein said, "Everything should be made as simple as possible, but not simpler" (Cover and Thomas 2001). CEOs and CFOs are intelligent people who would prefer to use their own language, and have a silver metric, but will adapt to the demands of running a successful business. That includes learning about brand equity (or whatever they choose to call their marketing asset) and how to measure it.

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