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The Three Drivers of Financial Value: How Marketers Can Unlock Bigger Budgets By Thinking Like Investors

By Jonathan Knowles
and Lisha Perez

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Foreword

Foreword by The B2B Institute

For B2B marketers, the relationship with finance can make or break a career. Finance teams drive decisions about how investments are made by the organization, and which projects take priority. They decide how value is measured, reported, and rewarded. Before a marketer ever gets the chance to influence customers, s/he must first convince the CFO that money spent on marketing will have a positive pay-off for the business. In short, a B2B marketer's top priority must be marketing to the CFO.

Yet few marketers speak "finance," and the misalignment between marketing and finance teams is a top pain point among senior marketing professionals. In fact, 61% of senior marketing leaders surveyed by Deloitte cited "demonstrating the impact of marketing actions on financial outcomes" as their top professional challenge. More than half of respondents (52%) said they felt increasing pressure from their CFO to prove the value of marketing (Deloitte, US CMO Survey, Fall 2023).

This paper builds from our earlier paper authored by Fran Cassidy and co-sponsored by the IPA. In that paper, we focused on the attitudes, mindsets, and behaviors that support a collaborative CMO-CFO relationship. The VALUE framework provided a guide for how marketers can approach their own learning and development as the springboard for cultural change within the organization.

In this paper, we respond to the desire that senior marketers have voiced to "get under the hood" of how marketing impacts key financial metrics. Our goal is to help marketing leaders demonstrate to their CFO – and other budget stakeholders – that they recognize their objective is to create cash flows for the business, and they know how to do so. The basis of effective collaboration between the CMO and CFO begins from the recognition that customers are the source of cash flow and that certain types of marketing are investments to secure these future customers.

To do this, we explore three primary drivers of financial value – growth, profit, and risk management – and outline the six ways that marketing contributes to value creation. We call these the six marketing levers.

We are pleased to work with Jonathan Knowles, one of the world's leading experts in the alignment of marketing and finance and a prolific author on these and related topics. His collaboration with The B2B Institute over the past year has distilled decades of experience as a practitioner, consultant, and advisor to create a robust framework for how marketers can describe their objectives and activities in language that their finance counterparts respect.

Thank you to everyone at LinkedIn who has contributed to this body of work.

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Jonathan Knowles

Jonathan Knowles is the founder of Type 2 Consulting and a leading expert on the alignment of marketing and finance. He has published more than 50 articles, 5 book chapters and one book about the role of brands in business, and the complementary nature of the finance and marketing disciplines. His analysis of value proposition, corporate purpose, post-merger branding, corporate reputation, and rethinking the 4Ps has resulted in five articles in the Harvard Business Review and fifteen in the MIT Sloan Management review where he co-authors "The Strategy of Change" series. He has a second book in development called *The 2 Whys and 6 Hows of Marketing*. Jonathan has an MBA from INSEAD.

Lisha Perez

Lisha Perez is a researcher and consultant at LinkedIn's The B2B Institute, she helps forward-thinking business leaders with innovative research from the world's leading experts. Her approach combines expertise in marketing & advertising with strong financial acumen to help companies identify and monetize new revenue streams.

Prior to LinkedIn, Lisha worked at Unilever where she led growth and profitability initiatives for several of the world's largest, most iconic brands. She holds an MBA from The Wharton School and is a previous Fulbright Scholar.

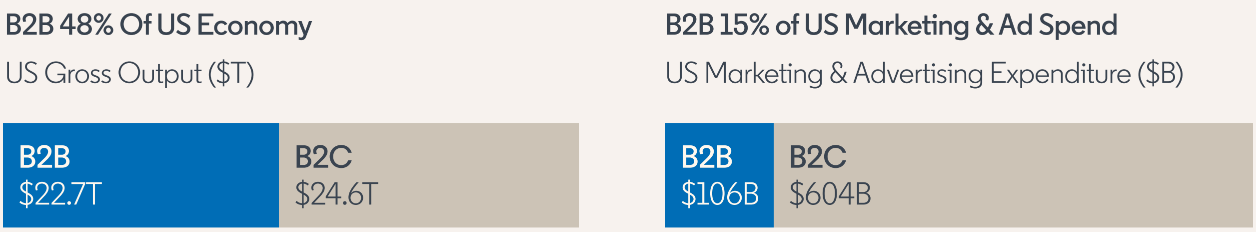
The B2B Budget Problem

In the fast-paced world of media and advertising, securing marketing budgets can feel like a constant battle. While marketers meticulously craft campaigns and fret over media metrics, the approval process often hinges on a single, crucial question: how will this translate into business outcomes? Herein lies the biggest challenge facing B2B marketers today – business is a numbers game, and marketers can be focused on the wrong numbers. We talk about clicks when we should be talking about cash.

This disconnect leaves CFOs skeptical about the priorities and practices of marketing. When marketers don't demonstrate a clear link between their activities and the company's bottom line, their budgets become easy targets for cuts, hindering long-term growth.

In B2B, the problem is outsized: B2B businesses represent nearly half (48%) of the US economy as measured by gross output, but only 15% of marketing and advertising spend.[1]

B2B's Contribution to the US Economy Far Exceeds its Proportion of US Marketing and Advertising Spend



Source: CEBR, US Bureau of Economic Statistics (March 2023), Plural Strategy US Marketing Spend Outlook (Jan 2023)

We are not suggesting B2B markets have the same dynamics as B2C markets, but we are suggesting that customer relationships are important in every industry. If B2B marketers had budgets in proportion to their contribution to the US economy, it would represent $235B in additional marketing and advertising spend to attract future generations of B2B customers.

To bridge the gap, marketers must reframe their contributions in the language that resonates with CFOs. We need to become financial storytellers, explaining how marketing's efforts – and the effectiveness principles that underlie them – impact financial outcomes.

1 Plural Strategy. "Marketing Spend Outlook 2023-2026: US Edition." Accessed May 17, 2024.

Our Solution

We've all heard "cash is king" so often that the phrase has become accepted without it being fully understood.

A company's valuation – its fair market value – is the discounted value of its anticipated future cash flows. This number reflects investor expectations about the size, growth, and certainty of these cash flows. For publicly traded firms, the share price is the amount that investors are willing to pay for a share of that future cash stream. That is why it is called a share!

The purpose of marketing is to attract and develop the customers with whom the business can have a profitable relationship over time. In the language of finance, this means that marketing's job is to sow and harvest cash flows. This language makes clear how marketing contributes to valuation, especially in B2B industries with long sales cycles. "Sowing" is about investing in relationships that will generate cash flows in the future while "harvesting" is about reaping the return from past investments in customer relationships.

To further clarify how marketing contributes to value creation, we draw on one of the foundational models in finance – the Gordon Growth Model – which is used to generate a first approximation of the value of an established business.

The Gordon Growth Model Provides an Initial Estimate of the Value of An Established Business

The Value of a Business

$$\text{Value} = \frac{\text{Profit}}{\text{Cost of Capital - Growth}}$$

or more technically

$$V_{Op} = \frac{FCF_1}{(WACC - g)}$$

The Gordon Growth Model says that the operating value of a business (VOp) with steady growth is equal to its free cash flow (FCF) divided by its weighted average cost of capital (WACC) minus its rate of growth (G).[2]

In plain English, this means that there are three – and only three – ways to enhance the valuation of a business:

1. Accelerate Growth – Increase the company's rate of earnings growth

2. Enhance Profit – Increase its current earnings

3. Mitigate Risk – Increase the certainty of future earnings, reducing the discount rate applied to them[3]

The Gordon Growth formula provides a simple explanation about why marketers are correct to focus on growth. Accelerating growth has a bigger impact on value – by reducing the denominator – than adding the same amount to profit in the numerator. Growth magnifies the value of profitable companies!

In their capacity as financial storytellers, marketers must explain how marketing is a commercial discipline that drives growth, enhances profit, and mitigates risk.

From Three Drivers of Financial Value, Six Marketing Levers

From these three drivers of financial value, we have derived the six levers that marketers can use to increase firm value.

Driver of Financial Value	Marketing Lever	Impact to Business
Growth	Customer Acquisition	Identify, attract and acquire new customers
	Customer Lifetime Value	Maximize the renewal and expansion potential of installed base
Profit	Customer Willingness to Pay	Increase customers' perceived value of brand offerings
	Supplier Willingness to Accept	Attract more favorable terms from suppliers and employees
Risk	Cash Flow Certainty	Improve the reliability and predictability of cash flows
	Alpha Generation	Use customer insights to maximize the probability of positive outcomes

2 The model is only used on mature businesses as the formula requires a combination of profitability and stable growth rate for valuation to be approximated this way. For early-stage companies that are currently unprofitable and in high growth, the regular DCF approach must be used for valuation.

3 The cost of capital reflects the level of return that equity and debt providers require to compensate them for the risk of those future profits not materializing.

Marketing Drives Growth

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Marketing Drives Growth

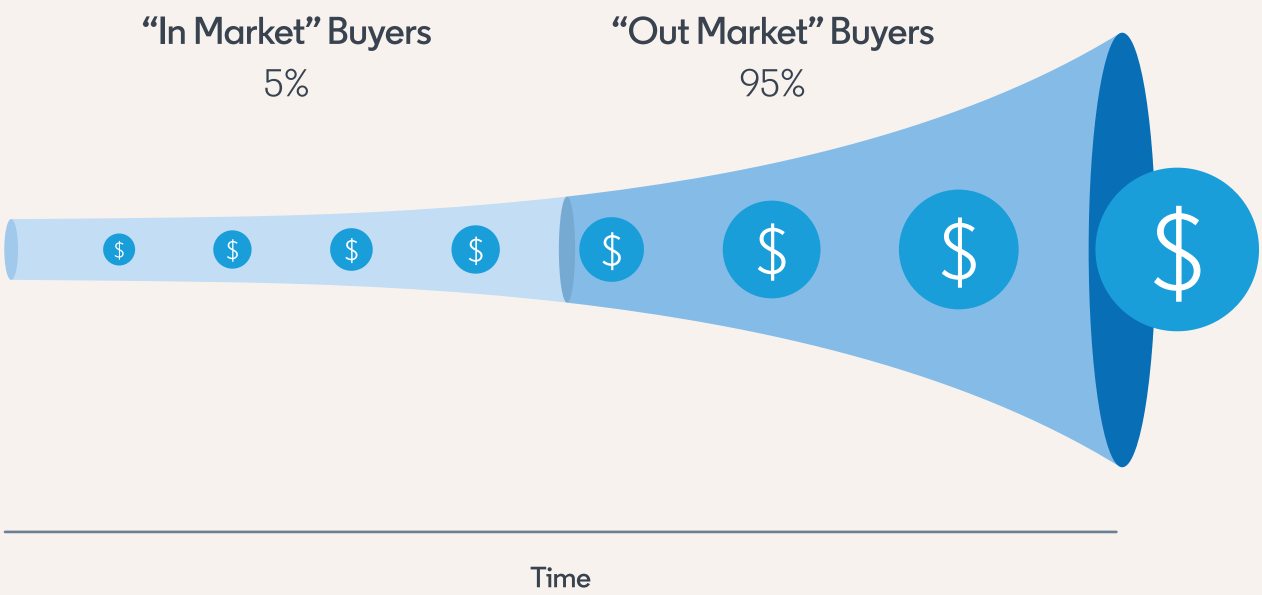
A company's value is determined by its ability to generate cash. This cash can be used for current needs – covering operating expenses and other current obligations – and to make the investments necessary to succeed in the future. Note that for an established company, its current cash is the consequence of the good investments it has made in the past.

Customers are the primary source of cash for any business (the exception is startups and scaleups who rely on debt and equity finance). Revenues that a company makes today are the result of past investment in customer relationships.

The dangerous assumption behind "performance marketing" is that sales can be made without relationships. This may be true in certain highly transactional environments – but these are rare in B2B. What is more common in B2B is that the sales transaction is preceded by an extended sales process, requiring close orchestration between marketing and sales.

The 95/5 Rule provides the rationale for a full funnel approach to B2B marketing by highlighting the extended nature of this sales process (the 95/5 "rule" is based on a five-year purchase cycle). The rule explains the necessity of addressing both in-market buyers – the source of current cash – and out-market buyers – the source of future cash. If a company is only doing "performance marketing" based on in-market buyers, it is failing to make the necessary investment in the 95% of buyers who are not in-market this quarter.

Future Cash Flows Come from Out-Market, Future Buyers

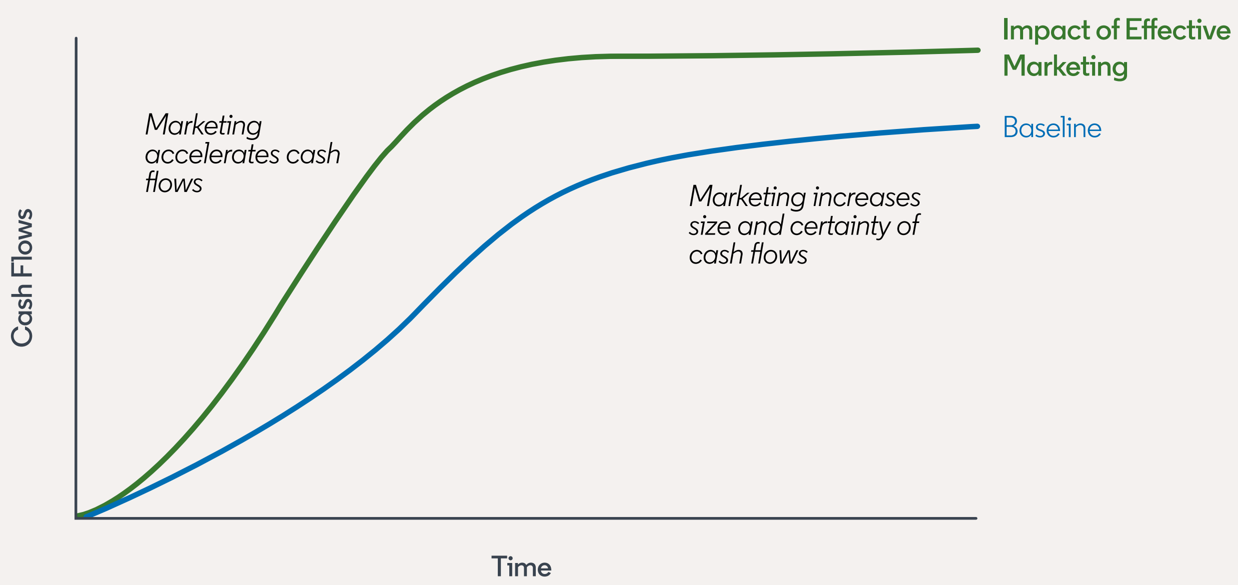


As mentioned previously, investors base their decisions on discounted cash flow (DCF) models. **It is typical for more than 70% of a company's share price to be attributable to its cash flows 5 or more years into the future.**[4]

CFOs, as the financial stewards of the company, are acutely aware of this connection between present and future performance. By strategically managing resources, their job is to ensure the company can generate cash flow in both the short term and the long term.

Recognizing the importance of "sowing" and "harvesting" customer relationships is the foundation for collaboration between the CMO and CFO that generates greater cash flows in the short and long-term.

Marketing Enhances Cash Flows Over Time



Effective marketing accelerates cash flows by allowing a company to more quickly scale its customer base through customer acquisition. It also increases the size and certainty of cash flows by customer lifetime value and higher predictability of demand.[5]

4 Lenglet, Romain, "Everything You Need to Know About Discounted Cash Flow (DCF): Definition, Calculation, Advantages and Limitations." Agicap. Accessed May 17, 2024.

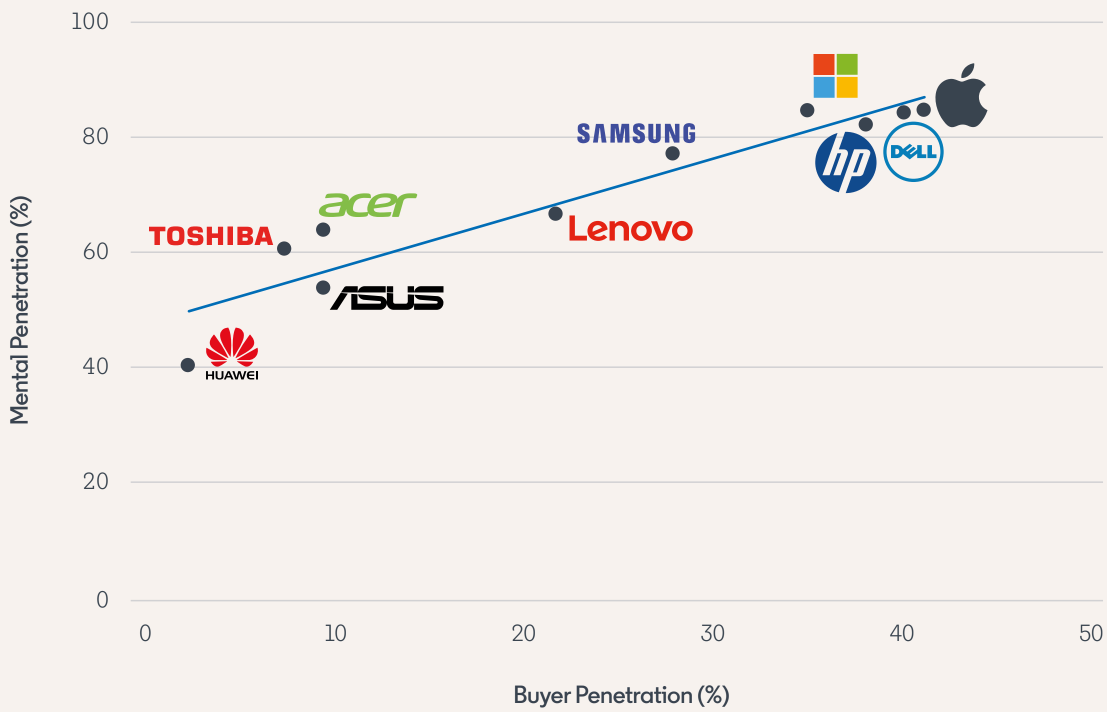
5 Srivastava, Rajendra et al. "Market-Based Assets and Shareholder Value: A Framework for Analysis," The Journal of Marketing, no. 62 (January 1998): 2-18.

Marketing Enhances Customer Acquisition

Imagine you are Lenovo and you are responsible for the B2B laptops business. On average, companies review their laptop suppliers once every four years. That means that only 6% of corporate accounts are "in-market" this quarter. That is a small pool of customers to fight over with Dell and Apple. Getting nervous? Now, consider that 8 of 10 of these in-market customers will have begun their procurement process with a shortlist of brands already in mind. Research estimates there are only three brands on that shortlist and that 9 out of 10 corporate customers will eventually choose a brand from that original list.[6]

Effective marketing gets your brand on that shortlist. It does this by improving your brand's "mental availability" – the term popularized by the Ehrenberg-Bass Institute to refer to the likelihood of your company being remembered in a buying situation. Mental availability is important because human beings are "cognitive misers" and rely on mental short-cuts for their decision-making ("heuristics" is the formal term used by the great psychologists Amos Tversky and Daniel Kahneman). Marketing establishes and reinforces memories that improve a brand's chance of being considered in buying situations. Mental availability – or association with at least one buying situation – correlates with higher buyer penetration.

Direct Positive Relationship Between Mental Penetration and Buyer Penetration



Source: LinkedIn. "Category Entry Points for Business Laptops/Hardware." March 2024.

6 Novack, Doug. "The New B2B Landscape: A Guide to Connecting with B2B Buyers." Marketing Drive (December 2022). Accessed May 10, 2024.

By building mental availability through strategic campaigns, marketing attracts new customers. A reliable flow of fresh customers is necessary to fuel growth and to offset churn – a reality for every business. The key is to target category buyers with the right messaging – linked to purchase occasions – to increase memorability and therefore conversion when customers enter the formal buying process. As The B2B Institute has outlined in previous papers, [the best way to reach out-market buyers is through top-of-the-funnel tactics.]

If the CFO asks:

"How is marketing helping us acquire new customers?"

The CMO can respond:

"Customers are the lifeblood of our business. Even though our customer retention rate is 92%, this still means we need to replace 24% of our customer base every three years just to maintain topline.

The goal of our marketing efforts is to create a pipeline of future customers. The average buyer has a shortlist of only 3 providers, and 9 out of 10 will pick a brand off that short list. We need to be known to customers at the very earliest point in their purchase cycle if we want to maximize the probability of being on the shortlist.

The buying cycle is typically three years out, so we are allocating budget to revenue opportunities that are two years out. These opportunities are best served by brand marketing efforts, which will increase our company's likelihood of being remembered as a provider of choice when they enter a buying situation."

Marketing Increases Customer Lifetime Value

Effective marketing goes beyond just attracting new customers. A well-crafted strategy can significantly enhance the customer lifetime value (CLV) of your existing customer base. In this sense, marketing acts like interest – it has a compounding effect on what you already own.

Managing customer lifetime value is especially important in the world of B2B, where the customer acquisition process is long, and the initial scale of purchases may be small. In these environments, driving customer lifetime value becomes even more crucial because so much of the potential value in the relationship relies on renewing and expanding the relationship beyond the initial commitment.

For example, let's say you run a cloud-based project management software company. You want to estimate the customer lifetime value of three cohorts of subscribers – one cohort who subscribe for a year (25% of the population), then cancel; one cohort who upgrade at the end of year 1 and stay for 4 more years (15% of the population); and the remainder that stay on the regular subscription for all 5 years but with a 90% renewal rate in years 2 through 5. In this simplified example, the "upgraded" population account for only 15% of subscribers but close to one third of the LTV of the total population. You can find the calculations for how to arrive at Customer Lifetime in Further Reading II.

Customer Lifetime Value of Three Customer Cohorts (Five Year View)

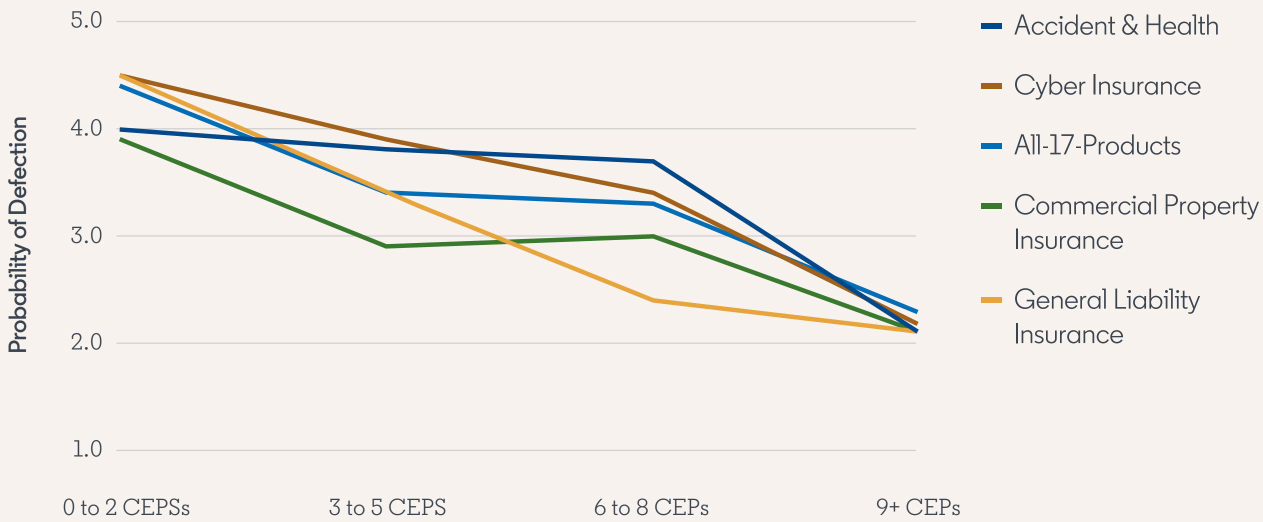
Cohort	Subscription Type	Customer Lifetime Value (Cohort Total)	% Customer Base	% Contribution Total Lifetime Value
Cohort 1	1 year	$300,000	25%	6%
Cohort 1	Upgraded (years 2 to 5)	$1,620,000	15%	32%
Cohort 1	Regular (5 years)	$3,196,080	60%	62%

This renewal and expansion dynamic is highly influenced by "social proof." As work by the B2B Institute and the Ehrenberg-Bass Institute has demonstrated, loyalty is heavily influenced by market share.[7] The Double Jeopardy Law shows that brands with more customers have higher loyalty than brands with fewer customers. This dynamic is particularly evident in B2C and SMB markets but also applies in B2B enterprise sales environments where "social proof" increases the effectiveness of the relationship development activities at the individual customer level.

Marketers can enhance loyalty through activities that reinforce mental availability. In the example below from the business insurance category, we see that brands that have associations with more buying situations – or "category entry points" – have lower probability of customer defection than brands with fewer associations.[8]

7 Romaniuk, Jenni et al. "How B2B Brands Grow." The B2B Institute Blog (August 2021). Accessed January 8, 2024.
8 Romaniuk, Jenni. "Category Entry Points in a B2B World: Linking Buying Situations to Brand Sales." The B2B Institute Blog (June 2022). Accessed April 1, 2024.

Association With More Buying Situations Reduces the Likelihood of Customer Defection Across Four Business Insurance Products



Not only does mental availability increase your overall share of in-market and out-market buyers, it also increases the likelihood of repeat purchase among your installed customer base.

If the CFO asks:

"How do our marketing efforts help with retention and customer lifetime value?"

The CMO can respond:

"Our marketing strategy is based on two drivers of growth – bringing new customers into our portfolio and realizing the full potential of these customer relationships once they are established.

First, we approach the customer acquisition aspect of growth by driving reach and recency of our message among prospective customers. Note that this also has a beneficial impact on customer retention – customers who have been exposed to our messaging are 20% less likely to defect.

Second, we support efforts to renew and expand our current customer relationships, working closely with sales and customer success. Our cohort analysis has allowed us to strategically design and manage cross-sell and upsell initiatives."

Key Takeaways on Growth

1. **Marketing drives customer acquisition by getting your brand on buyer's short list.** The majority of B2B buyers are not actively "in-market" in any given quarter. You can capture more of them by enhancing your brand's mental availability – or association with buying situations – through strategic marketing campaigns throughout the purchase lifecycle.

2. **Marketing enhances customer lifetime value through realizing the potential of your installed customer base.** This involves a focus on mental availability – or reinforcement of your company's association with buying situations – and the "social proof" that growing market share provides.It also involves relationship renewal and expansion through a focus on customer success.

Marketing Enhances Profit

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Marketing Enhances Profit

Profitability is the major preoccupation of CFOs. Profits not only mean happy investors, but also a war chest to fund exciting new projects and strategic acquisitions. This reinvestment fuels the engine of growth, leading to even more profit – a virtuous cycle that secures the company's future.

Strategic CFOs are equally invested in driving profitability both now and in the future. They understand that profitability is the fuel that allows them to invest in more R&D, staff development and innovative marketing campaigns, creating a win-win for both the financial health of the company and the success of these investment initiatives.

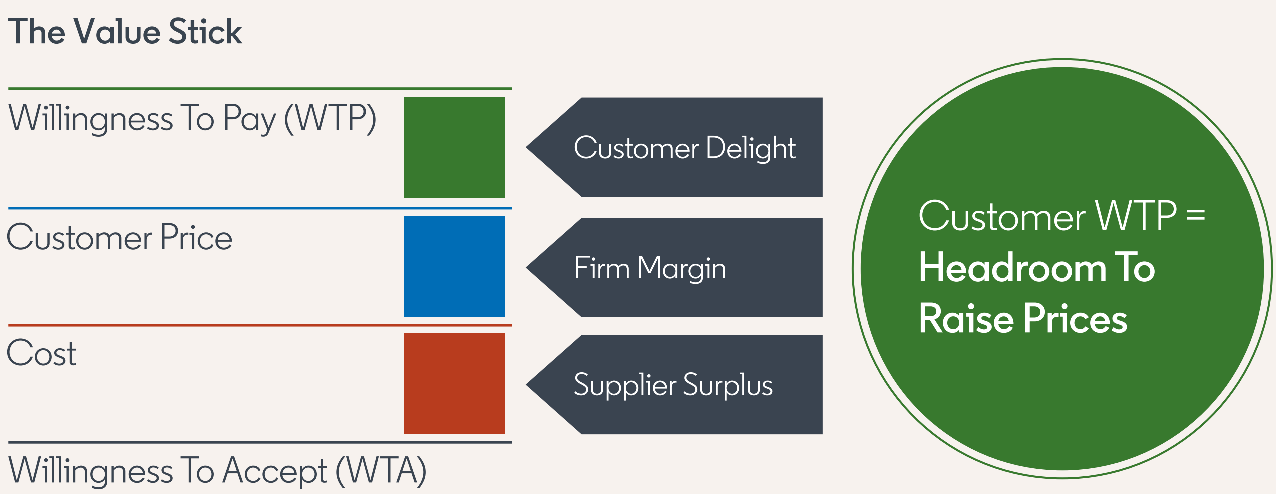
Strategic CMOs emphasize that strong brands create the opportunity for how and when profits are realized. Because strong brands have high perceived value in the eyes of customers, they have permission to charge higher prices – or for this preference to be expressed in higher volumes now and in the future. Effective marketing can also create benefits that extend to the supply side, such as inviting more favorable terms with suppliers, attracting high value talent, and creating cost efficiencies that drive margin expansion.

Marketing Creates Pricing Power

As Warren Buffet famously observed, "Price is what you pay. Value is what you get." Put another way, price is the number on the receipt, but value is your personal assessment of whether the transaction was worth it. B2B marketers who understand this distinction can contribute to firm profitability by enhancing customers' perceived value, and thus their willingness to pay for your brand.

The best illustration of this relationship is Dr. Felix Oberholzer-Gee's value stick framework. The value stick is a handy framework for value-based pricing, and thinking about how a firm must create value for both its customer and suppliers.

Dr. Oberholzer-Gee's "Value Stick" Shows How Marketing Can Enhance Margins



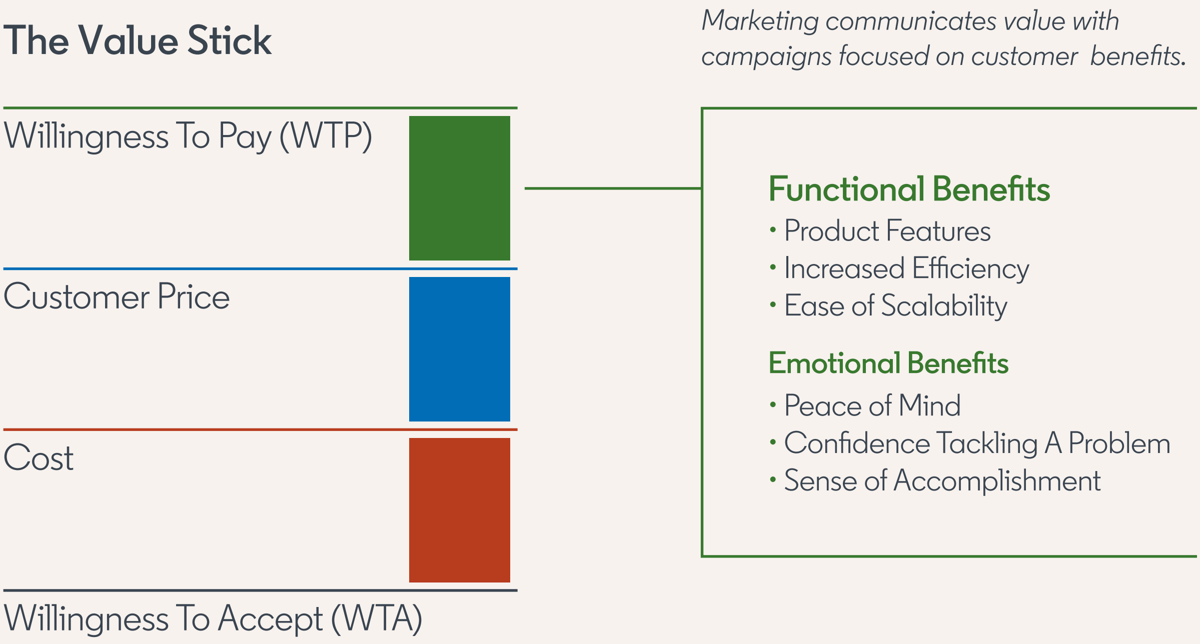
The value stick shows the relationship between four aspects of value: customer willingness to pay (WTP), price, cost, and supplier willingness to accept (WTA). The relative position on the stick of these four points determines how the value in the transaction is split between a firm, its customers, and its suppliers.

At the top of the value stick is willingness to pay (WTP). This represents the highest price a customer is willing to pay for your product or service. The difference between a customer's willingness to pay and the purchase price is known as customer delight (or, more formally, consumer surplus). This is the level of goodwill, loyalty, and enthusiasm a customer feels after making a purchase.

Price is what a firm receives when it sells a product or service. It is the point on the value stick that a firm has the most control over. It can be set at any point between firm's cost of production (the minimum price required to cover its costs) and its customers' willingness to pay (the maximum price that a customer is willing to pay). Whenever a transaction occurs, the value is split between the customer and the firm. Customer delight is the proportion captured by the customer; firm margin is the proportion captured by the firm.[9]

Marketing's role is to increase customer willingness to pay, creating headroom for higher pricing, which expands the opportunity for firm margin. It does this through strategic campaigns – linked to buying situations – that consider both the direct, functional benefits delivered by a product or service and the opportunity for added emotional benefits.

Marketing Increases Customer Willingness to Pay. Strong Brands Have Permission to Charge Higher Prices.



9 Stobierski, Tim. "A Beginner's Guide to Value Based Strategy." Harvard Business School Online (November 2022). Accessed March 10, 2024.

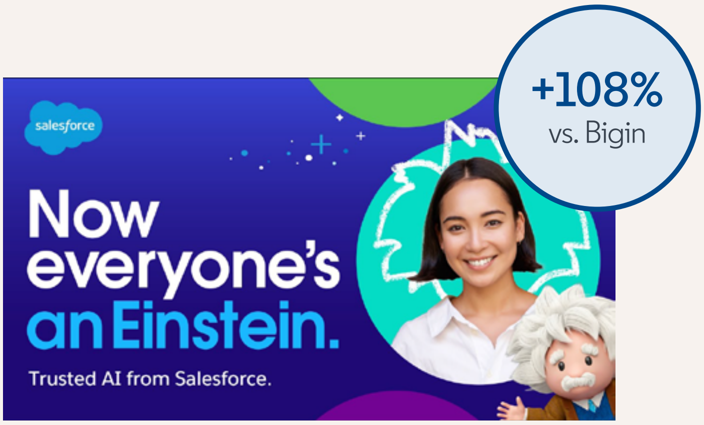
Functional benefits consist of a brand's observed level of functional performance and how this makes the brand suitable for certain types of tasks. It also includes the level of reliability of performance that comes from service agreements and other forms of warranty. These benefits inform what customers think about the product. Emotional benefits, on the other hand, focus on what customers should feel about the product. As Adam&eveDDB Group Head of Effectiveness Les Binet observed, "The key to pricing power is to get people to feel strongly about your brand, to disengage the rational and make people want the thing at any price." Only emotional advertising has the power to reduce price sensitivity and support premium pricing.

Consider these campaigns for Salesforce and Bigin by Zoho CRM. Both companies offer customer engagement platforms; both have offerings tailored to small businesses. Bigin's campaign speaks to functional benefits only – "automation for better small business productivity." Salesforce's campaign speaks to the functional and emotional benefit of being knowledgeable – "being an Einstein." With a strategy that influences how customers **feel** about the transaction – and thus the product's subjective value – Salesforce commands pricing that is more than twice that of Bigin.

Salesforce Supports Higher Pricing Through Advertising Focused On Emotional Benefits.

Functional Advertising

Opening Price Point: $12 Per Seat



Emotional Advertising

Opening Price Point: $25 Per Seat

Source: Zoho Bigin Premier SMB Pricing and Salesforce SMB Starter Suite Pricing

11 Valentine, Matthew. "Les Binet: Long-term brand building plus creative advertising is the key to firmer pricing." Marketing Week (April 21, 2023). Accessed May 20, 2024.

Emotional advertising leverages the foundation provided by observable functional benefits (notice the reference to "Trusted AI from Salesforce" that establishes functional credibility). By appealing to what the products means to the user (and not just what it does), this type of communication creates additional willingness to pay among customers, effectively "lengthening the value stick" and the total amount of value in the transaction, creating headroom for higher pricing. **By enhancing the customer's perception of value, emotional advertising creates permission for businesses to charge higher prices.**

If the CFO asks:

"Doesn't spending on marketing hurt our profitability?"

The CMO can respond:

"We have the highest list price in our industry and give lower discounts than any of our competitors. Despite this, our "value for money" ratings are in the top tier. If we were to eliminate marketing support, we would likely need to reduce prices by 10% to maintain the same "value for money" perception.

Cutting marketing would certainly give a one-time boost to profits this quarter. But we will need to reduce prices if we want to maintain sales volumes in the future.

We believe that eliminating marketing support would reduce profit margins by 1.5% within the next 18 months."

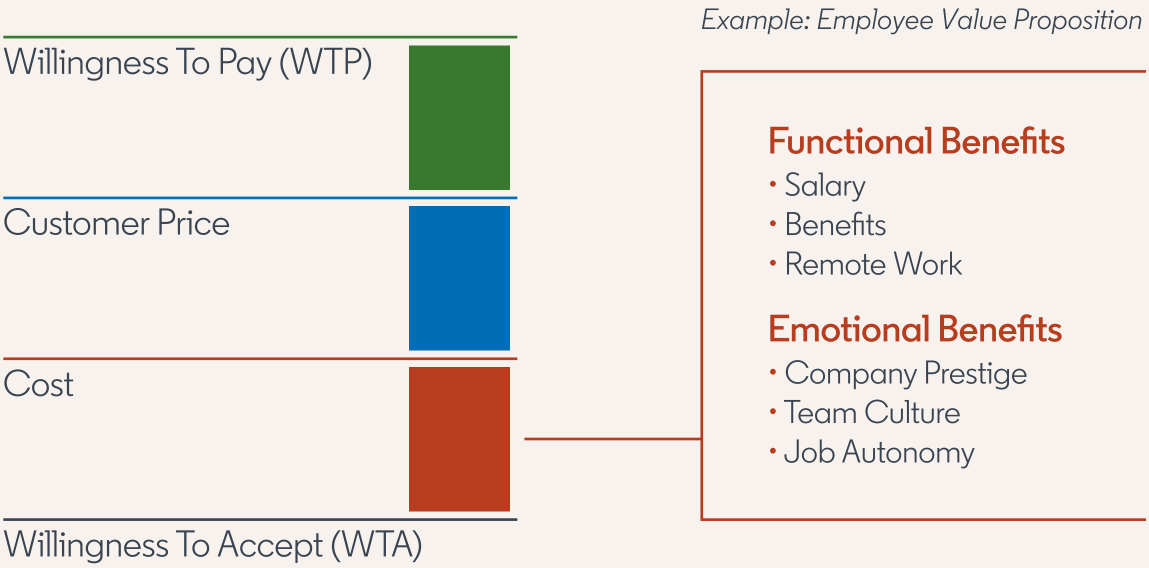
Marketing Creates Cost Efficiencies

Effective marketing creates a perception of value that extends to the entire company ecosystem, including suppliers and employees.

For suppliers, being associated with a successful and well-regarded brand becomes a badge of honor. For example, consider how suppliers think about Unilever, a company known for its commitment to environmental sustainability. A supplier of recycled plastics might be willing to offer a slight price reduction to be part of that narrative, gaining exposure and building their own reputation. (Being able to feature Unilever as a client would increase the effectiveness of the supplier's sales collateral.) This translates into lower input costs for the company, directly increasing the profit margin on each sale. As in the pricing example, effective marketing has also "lengthened the value stick" in this instance, creating an opportunity for the firm to reduce its cost basis in a way that also generates value for the supplier.

Effective Marketing Enhances Value for Suppliers and Employees, Thus Helping to Reduce Cost.

The Value Stick

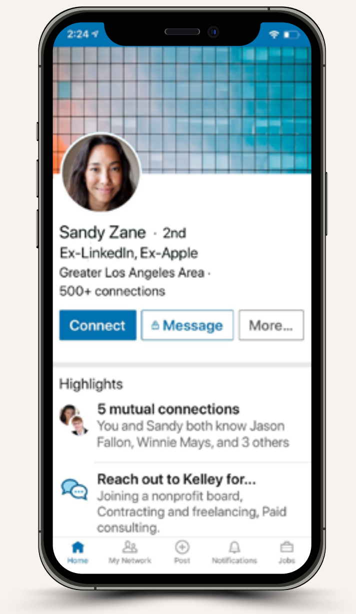


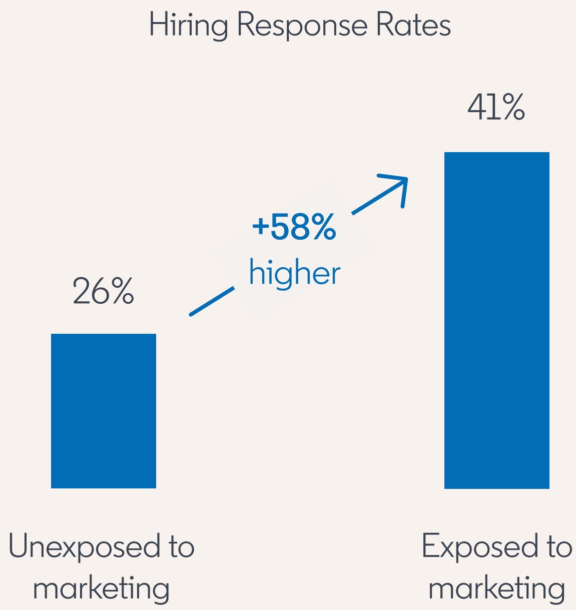
The employee aspect of the equation is equally impactful. Marketing that generates a favorable perception of the company supports the acquisition of top talent – and on favorable terms. Researchers have demonstrated a direct negative correlation between brand strength and executive compensation, implying that executives at companies with strong brands are willing to accept lower salaries in exchange for prestige. The authors found, “[These] empirical results suggest that the impact of these investments may touch those at the very pinnacle of firms: the top managers who are often accused of underappreciating the value of marketing at their firms.”[11]

LinkedIn platform data supports this hypothesis. Members exposed to a firm’s marketing are 58% more likely to respond to recruiters on platform than those who are unexposed.

11 Tavassoli, N. T. et al. “Employee-Based Brand Equity: Why Firms with Strong Brands Pay Their Executives Less.” The Journal of Marketing Research, 51(6): 676-690 (December 2014). Accessed February 14, 2024..

LinkedIn Platform Data: Strong Brands Have An Easier Time Hiring.





A motivated and aligned workforce is a source of cost efficiencies. Less turnover translates into lower recruitment and onboarding expenses. A well-known study by Gallup found that motivated, enthusiastic employees yield a +18% rise in productivity.[12] **By creating a place where people want to work, marketing reduces costs while boosting overall output.**

If the CFO asks:

"How is the marketing department driving cost discipline?"

The CMO can respond:

"Aside from our efforts to drive cost discipline across our own marketing efforts, our marketing is contributing to efficiencies in talent acquisition and supplier terms.

The strength of our brand is one of the principal reasons cited by recent recruits as a top three reason why they joined us. We are recruiting top-class talent despite offering salaries that are 8 to 10% lower than competition.

Procurement reports that our RFP for a new packaging supplier attracted more than 30 responses, with more than half proposing pricing that is 10% below that of our current supplier, and with payment terms of Net 120."

12 Gallup. "The Benefits of Employee Engagement." Last Updated January 7, 2023. Accessed April 5, 2024.

Key Takeaways on Profit

1. **Strong brands have higher perceived value and can therefore command higher prices.** Effective marketing can support pricing power by emphasizing the emotional benefits the customer derives from using the product.

2. **Marketing can also create cost side benefits.** Strong brands can command more favorable terms from both suppliers, and they have an easier time attracting and retaining talent.

Marketing Improves Risk Management

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Marketing Improves Risk Management

CFOs understand that strong, predictable cash flow is essential to a company's financial health. Unexpected disruptions can wreak havoc, jeopardizing the company's liquidity. At the same time, every CFO knows that a certain level of risk is necessary to generate a return that exceeds the cost of capital.

A defining quality of the best CFOs is their smart management of risk that enables them to deliver the superior risk-adjusted returns (known as "alpha") that investors are looking for. Risk management involves protecting against the unexpected while making smart bets that can pay off handsomely. By managing risk, CFOs ensure that a company has the steady flow of cash required to meet its current obligations while also having the funds to invest in future growth. They safeguard the company's present and future.

Few CMOs understand how to explain to their CFO the role that marketing can play in meeting both risk management priorities – and how essential the role of creativity is in both cases. One form of creativity is about maintaining the freshness of the brand's appeal to its core customers. This type of creativity is designed to increase the certainty of the revenues of the business (in finance terms, the aspect of risk management that focuses on reducing the volatility of earnings – and therefore stock price – is called "beta"). Then there is the disruptive form of creativity that is designed to change the way that current and prospective customers think about the business to generate an outsized customer response to the product). The aspect of risk management that focuses on how to place "smart bets" with an above-average expected return is called "alpha" (this is something of a simplification as, technically, "alpha" refers to any excess earnings over what was expected by investors).

Using the analogy of an investment portfolio, the first type of creativity acts as a broad market ETF by aiming to generate a solid return with low volatility. The second form of creativity is like venture capital investment in opportunities where there is a probability of making a return that is many times that of the original investment.

How much a company should allocate to each type of risk/return activity should form the very core of the agenda between the CMO and the CFO. The answer will vary greatly across individual companies based on industry and competitor dynamics, and where the company is in the lifecycle of its core products.

The ultimate goal of the CFO is to outperform investor expectations. As we talked about earlier, when investors value a company, they apply a discount rate to calculate the net present value of what they project to be a company's future cash flows. The share price only goes up when the company exceeds these expectations.

B2B CMOs who understand the importance of risk management to the overall financial health of the business – and marketing's role in creating confidence in the investor community – are well-positioned to advocate for their efforts to their finance colleagues.

Marketing Drives Cash Flow Certainty

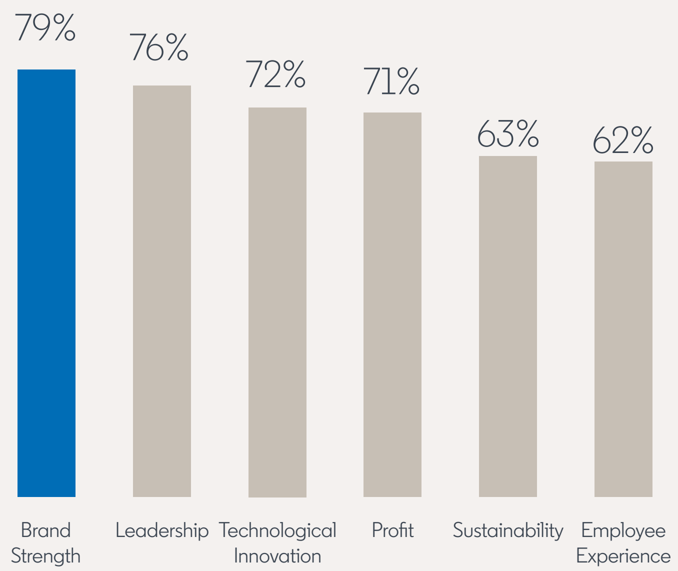
The amount that a company needs to pay for its debt and equity capital is directly related to the expected volatility in its earnings relative to the market (this is how its "beta" is calculated) and the strength of its profile in the market.

Brands improve cash flow certainty by creating a more stable customer base, which leads to a predictable level of demand. This is why strongly branded companies are perceived as less risky by investors. In a study conducted by the IPA, nearly 80% of investment analysts said that brand strength was a key factor in their appraisals of a business. They were more likely to select this factor than leadership quality, technological innovation, or even profitability.[13]

Investment Analysts Say Brand Important More Frequently Than Other Factors

Q. Thinking about public companies in the industry or industries you cover, how important are the following factors to your appraisal and analysis?

% responding "Very Important"



Source: IPA Effworks Investment Analyst Research (Sep 2023)

Companies with strong brands tend to have lower betas than their direct competitors, which has the effect of lowering their cost of capital.[14] A company with a beta of 0.8 suggests that for every 10% movement in the market, the company's share price will only fluctuate 8% in other words, investors expect that the earnings will be more resilient under adverse conditions.

13 Institute of Practitioners in Advertising. "New Evidence in the Case for Marketing Is an Investment." December 2023. Accessed May 5, 2024.
14 Madden, Thomas J. et al. "Brand Matter: An Empirical Investigation of Brand-Building Activities and the Creation of Shareholder Value." Journal of the Academy of Marketing Science 34(2): 224-235. April 2006.

From a valuation point of view, lowering the discount rate on future earnings has the effect of raising the present value of those earnings. **A reduction in perceived riskiness is financially equivalent to having a higher growth rate.**

If the CFO asks:

"How do our marketing efforts affect the risk profile of the business?"

The CMO can respond:

"We estimate that our brand strength lowers our cost of capital by 0.25% because of the increased level of investor confidence in our future earnings. This has the impact of increasing our market value by 6%."

Marketing Contributes to Alpha Generation

CFOs prioritize investments with attractive risk/return characteristics. This means thinking strategically about allocating capital across a portfolio of opportunities to produce the appropriate combination of low risk/return revenue and high risk/return revenues. Marketing's insight into customer preferences and competitor activity means the CMO offers an important perspective on the expected value of different initiatives, and the potential risks that could **impede their success.**

B2B CMOs can generate support from their colleagues by framing their campaigns as calculated investments with different risk/return profiles. Certain forms of marketing act as the protective armor for safeguarding the core revenues of the business; other forms of marketing are strategic bets on future sources of revenue (either among new or existing customers). By identifying risks and providing evidence-based assumptions about the market reactions, marketing helps to mitigate the inherent uncertainties associated with these "strategic bets" – whether new ventures, M&A, or embargoed company news such as leadership changes or restructures, or bold new marketing initiatives.

By framing the recommendations in terms of risk management, a CMO establishes the foundation for greater credibility. Defensible assumptions – backed by data-driven insights and market intelligence – are crucial. With pre-determined key performance indicators (KPIs) aligned with financial goals, pre-launch validation plans further strengthen the case, demonstrating the rigor behind marketing's approach to advertising and media.

Lastly, developing different scenarios for campaign performance, which include both optimistic and pessimistic outcomes, lays the groundwork for well-rounded risk management. Uncertainty is present in every business decision so, although it feels counter-intuitive, CMOs that explicitly discuss risk build greater trust and buy-in with their finance colleagues, and better position themselves as contributors to firm success.

If the CFO asks:
"How can marketing help ensure the success of our upcoming merger?"

The CMO can respond:
"The upcoming merger presents significant opportunity, but also inherent risks. Through rigorous market research and analysis, we have developed a communication strategy that will appeal to the customer and employee bases of each business, highlighting the specific advantages for each. I have built low, medium, and high spend scenarios that allow us to be increasingly customized in our messaging. When we meet next week, we can outline the key assumptions and discuss the range of resulting outcomes."

Key Takeaways on Risk

1. **Effective marketing can reduce a company's financial risk.** Strongly branded companies enjoy more predictability of demand, and therefore more certain cash flows. This results in a lower cost of capital and higher valuation for the company.

2. **Marketing can improve the payoff from "strategic bets" by identifying and mitigating potential risks with customer insights and intelligence.** By outlining potential risks and scenarios, marketing can help the CFO maximize the risk/return profile of key initiatives (specifically those impacting customers) and secure buy-in for marketing initiatives.

Conclusions

Conclusions

This white paper has clarified how marketing acts as a strategic driver of company value and share price. Specifically, we have emphasized the role of marketing in "sowing" and "harvesting" the cash flow that forms the foundation for the valuation of the business. Using the Gordon Growth Model, we've identified six marketing levers relating to the three drivers of financial value – growth, profitability, and risk management.

Three Drivers of Financial Value, Six Marketing Levers

Driver of Financial Value	Marketing Lever	Impact to Business
Growth	Customer Acquisition	Identify, attract and acquire new customers
	Customer Lifetime Value	Maximize the renewal and expansion potential of installed base
Profit	Customer Willingness to Pay	Increase customers' perceived value of brand offerings
	Supplier Willingness to Accept	Attract more favorable terms from suppliers and employees
Risk	Cash Flow Certainty	Improve the reliability and predictability of cash flows
	Alpha Generation	Use customer insights to maximize the probability of positive outcomes

This framework serves as a bridge, fostering collaboration between marketing and finance – two disciplines with complementary perspectives on value creation. Together they form a well-oiled machine: marketing, equipped with insight into customer preferences, identifies and attracts high-value customers, the source of the cash flows of the company. Finance, the architect of resource allocation, ensures the engine runs smoothly by allocating resources to the opportunities that deliver cash flow in the short- and long-term.

This white paper empowers you to be a champion for marketing's financial impact. By leveraging the concepts and insights outlined here, you can establish stronger relationships with finance. You will gain the confidence to speak the language of finance and articulate the measurable contribution your activities make to the company's bottom line. Ultimately, this paves the way for securing essential resources and optimizing marketing strategies – a win-win for both marketing and finance.

So, take the first step. Reach out to your finance counterparts, open a dialogue, and together, lay the foundation for a future of mutual success and sustainable growth.

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Further Reading I

The Relative Importance of Growth vs. Profit

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Further Reading I:
The Relative Importance of Growth vs. Profit

For many B2B businesses, the age-old debate of whether the business is best served by prioritizing growth over profitability remains unresolved. Marketers often champion growth initiatives, while finance teams focus on maximizing profits. However, the answer, like most things in business, isn't so black and white. The optimal strategy depends heavily on your industry and current financial performance.

This appendix explores the question through the lens of the Gordon Growth Model, a financial framework that helps us understand how growth and profitability influence a company's value. We'll then delve into specific takeaways for marketers based on their company's financial situation.

Understanding Valuation through the Gordon Growth Model

As described above, the Gordon Growth Model (GGM) calculates the value of a business based on its growth, profit and risk.

Here's a chart outlining a hypothetical scenario comparing two businesses (Companies A & B) with the same revenue but different profit margins:

Factor	Company A	Company B
Revenue	$100	$100
Cost of Capital (WACC)	10%	10%
Growth Rate	2%	2%
Profit Margin	12%	4%
Current Profit	$12	$4
Valuation Multiple (GGM)	12.5x	12.5x
Company Valuation	$150	$50

Company A is three times more valuable than Company B because it is earning three times as much in profit and both companies have the same growth rate and cost of capital.

Now imagine that each company has the opportunity to increase its level of profitability or rate of growth by 1%. What should they each do?

For Company A, the increase in growth rate from 2% to 3% boosts its value to $171:

- 12% Profit / 10% WACC – 3% Growth Rate

A similar increase in profit margin from 12% to 13% will increase its value to only $163:

- 13% Profit / 10% WACC – 2% Growth Rate

Contrast this with Business B where a 1% increase in growth rate from 2% to 3% increases its value to $57:

- 4% Profit / 10% WACC – 3% Growth Rate

A 1% increase in profit margin from 4% to 5% will increase its value to $62.50:

- 5% Profit / 10% WACC – 2% Growth Rate

Company A is better off focusing on growth while Company B is better off focusing on margin.

Takeaways for Marketers

- **High Margins, Focus on Growth:** Companies with high profit margins, like those in software or pharmaceuticals, benefit significantly from growth initiatives. A small increase in growth can lead to a substantial increase in valuation.
- **Low Margins, Focus on Efficiency:** For businesses with lower margins, such as construction or agriculture, improving efficiency and profitability is crucial before focusing on growth. Growth in this scenario might simply make the company bigger but not necessarily more valuable.
- **Negative Profits, Fix the Leaks First:** Businesses experiencing losses should prioritize cost-cutting measures and improving core operations to achieve profitability before seeking to grow (unless growth is the best way to improve its unit economics).

Conclusion

Understanding the interplay between growth, profitability, and risk management in company valuation empowers marketers to tailor their strategies to their specific business context. By collaborating with finance teams and using the Gordon Growth Model to understand the drivers of financial value, marketers can advocate for risk-attractive initiatives that demonstrably contribute to long-term shareholder value. Further Reading II: Calculating Customer Lifetime Value.

Further Reading II

Calculating Customer Lifetime Value

Further Reading II
Calculating Customer Lifetime Value

What is Customer Lifetime Value (CLV)?

Customer Lifetime Value (CLV) expresses the total contribution margin a customer is expected to generate throughout their relationship with a company. It considers how much revenue the customer generates, the cost of the underlying product, the cost of servicing the account, and how long they remain a customer.

The Basic CLV Formula:

CLV = ACV (Average Customer Value) x ACLS (Average Customer Lifespan)

- **ACV (Average Customer Value):** This is the average revenue a customer generates minus the direct and indirect costs of providing of servicing them.
- **ACLS (Average Customer Lifespan):** This represents the average time a customer remains a customer.

Calculating CLV: A Step-by-Step Example

Let's say you run a cloud-based project management software company. You want to estimate the customer lifetime value of your mid-sized business (SMB) tier plan. Here is how to break it down:

1. Average Customer Value (ACV):

- Your SMB plan costs $2,000 per month.
- Direct product and indirect costs are $1,000 month.
- Most SMB clients stay on this plan for a year (12 months) before renewing or cancelling.

Therefore, to calculate the ACV, we consider the contribution margin per customer per year:

ACV = Monthly Net Contribution x Number of Months = $1,000 per month x 12 months = $12,000 per customer.

2. Average Customer Lifespan (ACLS):

Your customer data reveals that:

- 25% of SMB clients cancel at the end of the first year
- 15% upgrade to a premium plan that costs $4,000 per month and has a contribution margin of $2,000 per month and stay for four more years then cancel at the end of year 5
- The remaining 60% renew the standard plan at a 90% retention rate for each of the next four years (10% churn annually) than cancel at the end of year 5

Based on these assumptions, the average customer lifespan is 3.66 years (25% of customers stay for 1 year; 49% of customers stay for 5 years; 26% of customers stay for between 2 and 4 years).

3. Customer Lifetime Value (CLV):

Now you can plug these values into the formula:

CLV = ACV x ACLS = $12,000 per "standard" customer x 3.66 years = $36,760 ($31,868 if the cash flows in years 2 to 5 are discounted at 10% per year)

Plus the value of the additional contribution margin for the 15% of customers subscribing to the premium plan for years 2 through 5 = $14,400 ($11,411 if these cash flows are discounted at 10% per year)

According to this simplified example, the average SMB client using your project management software generates $51,160 in contribution margin over 5 years ($43,279 in present value terms).

Of this total, the three cohorts of customers each represent the following amounts:

- Standard plan – cancel after one year: 6%
- Standard plan – renew but with 10% attrition: 62%
- Standard plan for year 1 then upgrade to the premium plan for 4 years: 32%

Key Takeaway for Marketers:

By understanding CLV, it is easier to make informed decisions about customer acquisition, marketing spend, and retention strategies.

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