

Creating Value by Improving Marketing Return on Investment

As the electric and gas retail industry has continued to gain market share and acceptance, the level of challenges it faces has also continued to grow. New entrants and consolidation are changing the landscape. In addition, the renewed focus on energy efficiency, demand response and renewables are creating a new set of opportunities. Retailers will also need to further develop new products and services to be able to increase market penetration and shareholder value. It is in this context that marketing decisions need to be made and be justified on a financial basis.

Marketing is, and always will be, a creative endeavor. But it can also be a highly rigorous discipline. As marketing noise and media fragmentation continue to increase, marketers find that Oliver Wyman's unique approach of econometric analysis with scientific customer value engineering and in-market experimentation allows them to better communicate with their customers—and substantially raise the effectiveness of their marketing spend.

Oliver Wyman's Marketing Value Engineering platform has helped clients realize gross profit improvements of at least 5% through revenue increases or spending reductions. We work with executives across a range of industries to untangle their many marketing initiatives and determine the optimal deployment of limited marketing investments and resources. By applying these marketing techniques, electric and gas retail executives can increase the value of their programs in the long run.



The Marketer's Challenges

In their quest for revenue and earnings growth, retail marketing executives must place a daunting array of make-or-break bets. They have to develop new offers; make brand, channel, and marketing moves; differentiate themselves against other competitors and incumbent utility companies; and fight for market share. In today's marketplace, there's less margin for error, so executives need more than the right answers; they. They also need a more effective and efficient process to reach consensus and push for fast and successful execution. The success or failure of these bets will be determined in each case by how the customer responds. But trying to anticipate shifts in customers' priorities is a tricky proposition. The challenge is to discover the next big thing that customers will value or how customers will react to different offers and services.

In addition, consumers and business customers are bombarded daily with hundreds of marketing messages delivered through all manner of media. The proliferation of media and marketing channels, from satellite radio to niche websites to 500 television channels to digital video recorders to iPods, has further complicated the environment. The vast majority of these messages fail to hit their targets. So when it comes to marketing investments, marketing executives do not have the same clear picture as with other functions; too often, they suspect missed opportunities and suboptimal spending. The challenge here is to develop new ways to improve marketing effectiveness in order to better reach customers.

How We Help

Oliver Wyman's Marketing Value Engineering platform is centered on several key elements:

- An objective, customer-centric framework to rigorously evaluate the impact of marketing investments
- Sophisticated modeling and tools that combine econometric analysis with predictive scientific experimentation, to help craft the most effective future campaigns
- An interactive decision-support system
- Proven processes to institutionalize the overall marketing productivity improvement effort

We can help electric and gas retail executives answer the following questions:

- How effective and efficient is my marketing spend?
- Where could I trim spend without negative revenue impact?
- What should I do to optimize the value associated with the next product release?
- How do I understand customers' priorities and tradeoff mentality?
- How do I break into a new space, such as small and medium businesses?
- How do I ensure that I'm making the right pricing moves?
- How can I reallocate marketing investments to generate higher returns?
- Where should I invest more to generate optimal returns?

Our Approach

The Marketing Value Engineering platform brings together three complementary methodologies to understand the link between marketing spend and key outcomes: Customer Value Engineering™ (CVE) econometric analysis, and in-market experimentation, as depicted below.

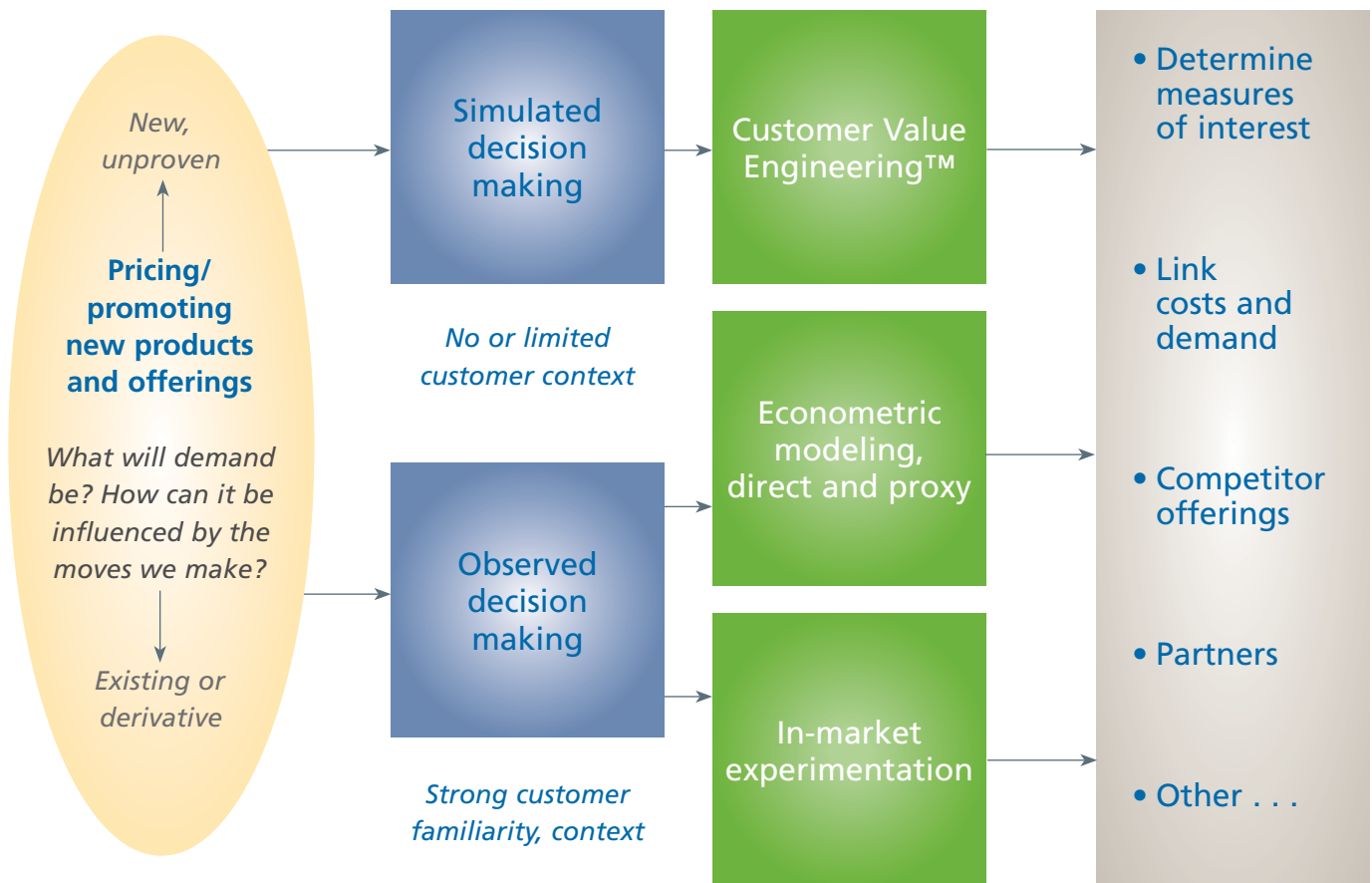
Customer Value Engineering™

Oliver Wyman's CVE platform uses demand simulation and decision-support techniques that integrate the insights of future customer demand with the microeconomics of the business. When applied to new, unproven products or services, CVE can provide insight into what customers value, how those priorities link to profitability, and what levers can be pulled to improve performance. This allows our clients to make highly informed decisions with minimal risk,

driving significant growth in revenues, margins, sales close rates, and average deal size. For example, a retailer will be able to simulate what the customer response to a new product or service offering, such as a green option, would be.

Electric and gas retail executives can reap two key benefits from CVE. They will have the ability to *see the future* by identifying and quantifying the true, emerging drivers of customer value in a competitive context. And they will be able to *drive to action* by recognizing and interactively testing the bottom-line impact of alternate strategies and reaching management consensus on critical actions. CVE allows executives to answer critical questions about how to optimize offers, reduce the risk of major business design moves and investments, and identify the next profit zones.

Marketing Value Engineering



Econometric Analysis

Oliver Wyman uses advanced econometric modeling techniques to assess which marketing resources and activities drive key outcomes such as customer acquisition, customer churn, revenues, market share, and brand strength. We start by developing a comprehensive base of existing data on client and competitive marketing activities and spending levels, by markets, channels, product categories, and brands, as well as data on environmental factors such as macro-economic variables. The databases help quantify the relationship between different marketing levers and key outcomes metrics.

Historical data, however, has a few limitations: It cannot quantify the effects of levers that have not varied much in the past; it cannot project the impact of substantially new and different levels of spend; and it cannot measure the impact of new marketing levers such as viral marketing that have limited, if any, historical data. That is why we often complement it with in-market experimentation.

In-Market Experimentation

Experimental design quantifies the effects of independent stimuli on key outcome metrics, in order to determine how the various components of a marketing campaign influence consumer behavior. Our proprietary In-market experimentation methodology is more precise and cost-effective than traditional market testing such as split mailings, which cannot evaluate more than a few campaign alternatives without growing prohibitively expensive. We help clients increase their marketing effectiveness by:

- Simultaneously testing and measuring thousands of combinations of marketing messages and identifying the key variables or attributes that generate the highest response rates
- Rapidly redesigning and implementing the offering to accelerate and maximize response rates, often saving nine or more months over traditional “test and learn” marketing techniques.

In-market experimentation quickly tests many marketing message combinations to identify the right offer, message, and channel. It lets marketers project the impact of many stimuli, even beyond those that have been used in the past, by testing just a few of them. Using mathematical formulas to select and test a subset of combinations of variables that represent the complexity of all the original variables, marketers can model hundreds or even thousands of stimuli accurately and efficiently. This ensures that our clients discover which stimuli are truly driving behavior.

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Because we control the introduction of stimuli, we can establish the differences in response that can be attributed to the stimulus in question, such as the

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	Traditional marketing approach	In-market experimentation
Customers <i>Whom to test?</i>	<ul style="list-style-type: none"> • Single test and control group 	<ul style="list-style-type: none"> • Multiple simultaneous tests for numerous customer segments
Design <i>What to test?</i>	<ul style="list-style-type: none"> • Usually limited to very few variables at one time • Controlled environment to understand influence of the selected variables 	<ul style="list-style-type: none"> • Large number of variables tested simultaneously • Statistical analyses used to isolate impact of each variable
Implementation <i>When to test and roll out?</i>	<ul style="list-style-type: none"> • Long lead times for testing and implementation 	<ul style="list-style-type: none"> • Test launch and initial test readout in 3-4 months

advertising message, and not to other factors, such as packaging. For example, electric and gas retailers can test the impact of offering incentives to customers and determine the overall lift on response and sales rates. This reveals whether variables caused a certain behavior as opposed to simply being correlated with the behavior. We also use this methodology to validate the results of the econometric analysis.

Delivering real bottom-line impact

Oliver Wyman's Marketing Value Engineering platform helps clients increase their gross profits by driving revenue increases or reducing marketing spend. Our clients have realized sales increases of 5-10% at the same levels of spend, or have achieved 10-15% reductions in marketing spend with little or no adverse revenue impact. Overall, gross profit improvements of 5% are typical. Our proven approach allows executives to develop a deep understanding of all customer touchpoints and the impact of spending by marketing lever, customer segment, geography, and channel on key outcomes such as sales, penetration, customer

acquisition, churn, market share, and brand strength. By combining historical analysis with in-market experimentation, we can help companies arrive at an optimal deployment of limited resources.

In-market experimentation for telecommunications, financial services, and publishing has had impacts in the following ranges:

- Telemarketing and call centers: 20% to 100% revenue lift
- Direct mail: 15% to 35% revenue lift
- Mass media: 40% to 50% response lift (best case versus none)
- Email campaign: 1.5 times revenue from promotions (best case versus base case)
- Internet advertising: 1.8 times revenue (best case versus base case)

Client Example: Driving Increased Penetration of Electronic Billing and Payment Options

A leading utility wanted to switch customers from traditional paper-based billing and payment processing to electronic billing and payment processing, in order to attain a 40% reduction in cost per bill. This was a major task, as over 90% of customer billing transactions and nearly 60% of payment transactions were done by mail. With an estimated \$500,000 in lifetime savings for every 100,000 converted customers at stake, Oliver Wyman worked with the client to develop a plan to achieve these savings.

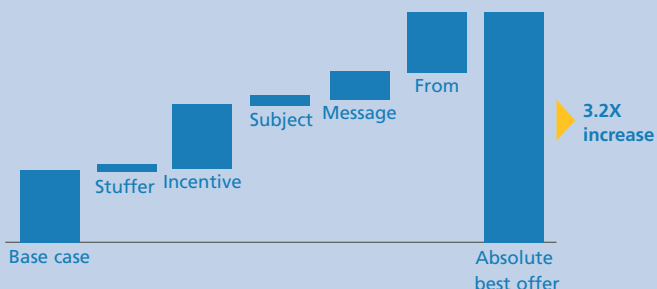
Using e-mail as the channel, we developed several in-market experimentation tests and decided to test 2,400 different messages. Some of the features to be tested included: different e-mail "from" and "subject" lines, different product offerings (e.g., an individual bill payment option versus a bundle of payment and billing options), additional marketing messages around the time of the e-mail, different benefits emphasized, and different levels of incentives (e.g., cash back or sweepstakes).

Using Oliver Wyman's In-market experimentation, we identified several attributes that provided the largest lift on click-through rate and thus constituted the best offer.

Some of those attributes emphasized the importance of the message benefit, while others emphasized the importance of receiving an additional financial incentive. However, the utility also learned that certain attributes did not provide the lift required to make the strategy work, such as e-mail subject lines.

The projected click-through rates using the redesigned "absolute best offer" proved to be 3.2 times more effective, as shown below. This exceeded expectations and provided new insights about the impact of marketing variables. Most importantly, the benefits were measurable, participative, and could be applied to other customer communications and across various channels.

Projected click-through rates using redesigned offer



Oliver Wyman's Edge

As one of the largest international management consulting firms, Oliver Wyman brings a number of important advantages to our client engagements.

- **Expertise.** For more than two decades, we have led the consulting industry in bringing the most innovative customer science methods to bear on our clients' business problems. For example, in 1984 Oliver Wyman was the first firm to apply Strategic Choice Analysis® to customer demand issues. We also pioneered the commercialization of latent class models, Hierarchical Bayes random effects models, Information Acceleration™, Nexperiment™, and Strategic Brand AssessmentSM.
- **People.** Having an in-house customer science team allows us to maintain the highest quality standards. Most of our specialist consultants

have doctorate degrees in marketing, economics, statistics, anthropology, or psychology. They have published in leading journals such as the *Harvard Business Review*, *Harvard Management Update*, *The Journal of Marketing Research*, *The Journal of Professional Pricing*, *Marketing Management*, and they have presented at industry conferences.

- **Technology.** We do not offer a secret "black-box" approach. Instead, we fully transfer knowledge so that clients can make ongoing refinements. Our CVE methodology, which integrates customer insight with the business economics, creates a platform for building consensus. And our custom desktop tools such as Interactive Strategy Modeling® are designed jointly with clients for maximum effectiveness and adoption. ❖

Oliver Wyman

With more than 2,900 professionals in over 40 cities around the globe, Oliver Wyman is the leading management consulting firm that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, organizational transformation, and leadership development. The firm helps clients optimize their businesses, improve their operations and risk profile, and accelerate their organizational performance to seize the most attractive opportunities. Oliver Wyman is part of Marsh & McLennan Companies [NYSE: MMC]. For more information, visit www.oliverwyman.com.

Oliver Wyman's Energy Practice

Our dedicated consultants have significant experience in the energy and utilities sector. Previous clients include more than 75 electric and natural gas utilities in North America and Europe, as well as a range of unregulated service providers to energy companies and utilities.

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