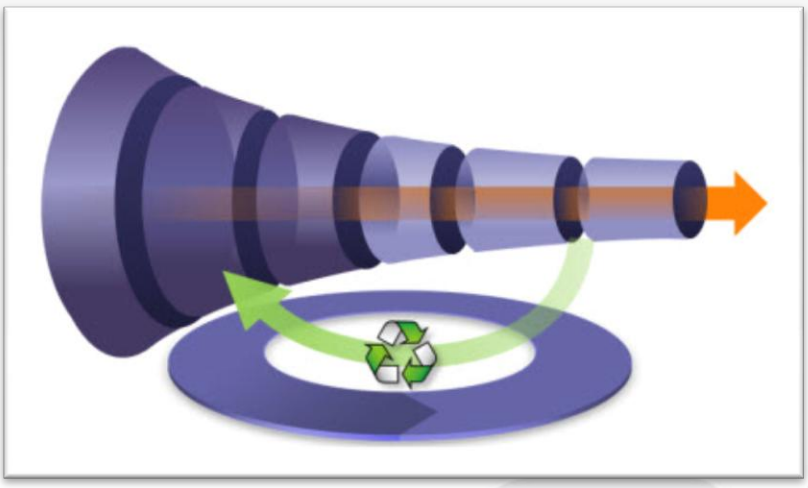
Marketing Forecasting:

The Hidden Secret of Today's Most Accountable CMOs



At executive staff and board meetings, the number one topic of discussion is never the upcoming marketing program or the new brand strategy – it's almost always the sales forecast. Everyone wants to know if the company will make the target for this quarter and what next quarter is going to look like. Invariably, the Chief Sales Officer (CSO) leads this discussion with little or no input from the CMO or marketing team. With this dynamic, it is no wonder that most executives think of marketing as a cost center and not an essential part of the revenue team.

Forecasts matter. CEOs and boards are impressed by accurate, forward-looking forecasts – and they are even more impressed the further out the CSO can make predictions with confidence. This ability to make revenue forecasts – and to be held accountable for delivering against them – is the single biggest factor that gives the sales function more credibility (and power) than marketing at most companies.

However, because the sales forecast is based on what specific accounts will do at specific times, it becomes increasingly inaccurate the further out you look. Asking the sales organization — which by definition is focused on revenue in the near term — to predict revenue in future periods can be highly misleading.

In contrast, there is a function that is inherently more focused on the long term: **the marketing organization**. That is why today's most accountable CMOs are stepping up to deliver a forecast of their own, one that uses analytical rigor and a deep understanding of how prospects move through the revenue cycle. For these CMOs, marketing forecasting delivers benefits such as:

- **Better justification for the marketing budget.** Marketing forecasting quantifies the exact revenue impact of any increase or decrease in marketing investment, giving the CMO the tools to make a rigorous business case for more investment.
- **More stability and predictability in revenue.** Since marketing forecasts invariably look further out than sales forecasts, they provide a more accurate and longer-term view of revenue. This also helps manage assets such as cash flow, inventory, and staffing, preventing lost revenue because of insufficient resources.
- **More power and influence for marketing.** By talking about marketing in terms of outputs (revenue) and not inputs (e.g. budget and programs), marketing forecasting positions marketing as a revenue center that deserves investment to improve profits, not a cost center to be cut.
- **Higher compensation for marketing.** When CMOs take on more responsibility – and risk – for revenue, their compensation begins to look more like their sales counterparts. While not every CMO is comfortable with this risk-reward tradeoff, it ultimately is an essential evolution for highly accountable CMOs.

In this paper, we will explore why CSOs increasingly have limited insight into revenue for future periods, discuss why marketing can and should take more responsibility for forecasting, and share a **revolutionary new methodology for implementing modern marketing forecasting in your organization**.

Cloudy Crystal Balls: Why CSOs Have Limited Visibility into the Future

CSO Insights reports in their 2010 Sales Performance Optimization survey that 51.4% of companies say their ability to accurately forecast revenue needs improvement, and only 5.1% say their ability exceeds expectations. Why are forecasts so inaccurate? Common reasons include lack of clear processes and methodologies, overreliance on error-prone spreadsheets, and limited incentives for accuracy.

These are all valid reasons, but perhaps the largest and most overlooked reason is that sales forecasting is inherently a "bottom-up" calculation, dependent on making gut-based or statistical predictions about which active deals will close. Given the law of large numbers, this can be highly accurate – but it completely misses the role of new opportunities that have not yet entered the sales pipeline. In other words, it ignores the deals that will close in the forecast period but are not yet active.

For example, take a company with an average sales cycle of 120 days. This is an average of some deals with short cycles and a long tail of deals with much longer cycles. This means that in any given quarter as much as 50% of the closed deals will be "fast movers" with sales cycles under 90 days – meaning at the beginning of the quarter the CSO did not have any visibility into them. The shorter the sales cycle, the worse the problem.

Put simply, the shorter the sales cycle the less visibility the CSO has into future performance.

Modern buying behaviors are making the problem worse, not better. In the days of "information scarcity" (aka before Google), the main way a buyer could get the information they needed was to engage with an account executive from a company. This meant that sales reps engaged with buyers early in the buying process, and had better visibility about what was coming down the road. Today, however, information is abundant and readily accessible over search and social media, so buyers want to educate themselves before they engage with a sales rep. As a result, buyers today are much further down their buying process – making it harder than ever for sales to forecast future periods accurately.

Marketing Forecasting Done Right

In cases where the CSO lacks "bottom-up" visibility into future periods, highly accountable CMOs can fill the void with marketing forecasts.

These are not "traditional" marketing forecasts, which take the form of a top-down market size analysis. Those kinds of "forecasts" can be useful for strategic planning, but do not have the sufficient granular, actionable data required in order to be an equal counterpart to the sales forecast.

In contrast, highly accountable marketing forecasts enable the CMO to make statements such as, "**Next quarter, marketing will generate an incremental 30 new deals worth $4.0 million of bookings that are not currently in the sales forecast**." Done right, the marketing forecast gives the CMO the confidence to stake a portion of his or her compensation on meeting the goal, and the CSO relies on marketing's input to make a valid forecast for the period.

Marketing is uniquely able to make these forecasts because marketing has visibility into the early stages of the revenue cycle.

The reason why marketing is uniquely able to make these forecasts is that marketing has visibility into the early stages of the revenue cycle. Marketing knows how many leads will be generated in a given period, and how those leads move through various stages of lead nurturing and qualification before they are sales ready. Marketing knows which marketing programs will generate new leads, and how leads of that type historically perform. Marketing also knows how fast different types of leads move through the system. By knowing how many prospects are in each stage of the revenue cycle and understanding how prospects move through the various stages over time, the CMO can build a model that forecasts how many new leads, opportunities, and new customers the system will create in future periods. Combined with solid management oversight to ensure valid inputs and qualitative "sanity checking" of the conclusions, the result is a forecast that the entire company can count on to make decisions.

In order to manage a successful marketing forecast, you need three things: a **methodology** that defines the stages of the complete revenue cycle and tracks how leads of different types move through the various stages; **measurements and incentives** to encourage trust, accuracy and accountability; and **tools** to take the manual effort out of the equation where possible.

Methodology for Marketing Forecasting

The methodology for making accurate marketing forecasts is simple in concept even though the details can get quite sophisticated:

1. Model the stages of your complete revenue cycle
2. Specify the types of leads you'll want to track and roll-up
3. Measure how each type of lead moves through the various stages (conversion percentage and velocity)
4. Get accurate inputs for how many new leads of each type your marketing team will put into the system
5. Model the flow of current and new leads through the various stages over time
6. Review the results and apply management judgment to finalize the forecast

1. Model Your Revenue Stages

Traditional sales methodologies, such as SPIN Selling and Miller-Heiman, provide standard benchmarks and best practices for the sales function. Whether it is "Situation", "Problem", "Implication" and "Payoff", or any other defined process, the stages provide the CSO with a framework for making forecasts, e.g. Stage 1 is 10% likely to close, Stage 5 is 70% likely, etc.

However, these sales methodologies do not provide a sufficient view of what is coming from the earlier stages of the revenue process; put simply, they leave marketing out and are therefore limited for modern forecasting.

That is why the first step in making a marketing forecast is defining the revenue stages a prospect can pass through. These can be as simple as "All Names", "Marketing Qualified Lead", "Sales Qualified Lead", "Sales Accepted Lead", etc., or you can add additional stages to model more complex movements through the buying process.

By formally defining each stage, as well as the business rules that determine when a prospect moves from one stage to the next, you can begin to understand the dynamics of how your prospects flow through the pipeline over time – and then use that understanding to start making forecasts about how they will flow in the future.

There are many ways to model the revenue stages for a company, but fundamentally, there are only three categories of stages:

- **Inventory Stages**: An inventory stage is a "holding pool" where leads and accounts can sit until they are ready to move to another stage. A lead can be in an inventory stage for one day or one year or more – by definition there is no time limit on an inventory stage. Common examples of inventory stages include the prospect pool, where leads are nurtured until they are sales-ready, and active opportunities that are being worked on but are not committed to a certain time. A best practice is to have relatively few inventory stages (e.g. one in marketing and one in sales) so that there are no places where leads can sit idle.
- **Gate Stages**: A gate stage is a simple qualification check with no time dimension. For example, say your company only wants leads for companies with more than $100 million in revenue. When a lead hits the gate stage, if the company has more than $100 million in revenue then the lead moves to the next stage; if not, it moves to the disqualified stage.
- **SLA Stages**: SLA stands for "service level agreement". These stages are used when there is a defined maximum time in which a lead needs to be evaluated or processed before moving forward or out of the process. For example, when a lead is determined to be "sales ready" it could move into a "marketing qualified lead" SLA stage where the appropriate sales representative has 14 days to contact the lead and decide whether to accept the lead, disqualify it, or recycle it back for further nurturing. If a lead is in that stage for more than 14 days, it

becomes “stale” – which can trigger a process of alerting sales management or even reassigning the lead to a different sales rep.

Using these three types of stages, you can model your entire revenue cycle (lead lifecycle). First, define your “**happy path**”, e.g. the traditional marketing to sales funnel that leads linearly from new lead to closed won business. Here is a sample set of revenue stages:

HAPPY PATH STAGES	REVIEW NEW NAMES	PROSPECT	LEAD	OPPORTUNITY	CUSTOMER
Category	***Gate***	***Inventory***	***SLA - 21 day***	***Inventory***	***Inventory***
Definition	*Review if new names are qualified*	*Qualified prospects who are not yet sales ready*	*Marketing qualified leads (“sales ready”)*	*Sales accepted leads, actively working*	*Closed Won deals*

There is a relatively simple model; you may have more stages and even model additional stages after Closed Won deals to model the customer lifecycle.

However, recognizing that not all leads follow a linear “happy path”, you should also define your “detour stages” to capture leads that are not qualified, or that require a few rounds of nurturing before becoming ready. For example:

DETOUR STAGES	DISQUALIFIED	INACTIVE	RECYCLED	LOST
Category	***Inventory***	***Inventory***	***Inventory***	***Inventory***
Definition	*Names marked as not-in profile*	*Prospects that have gone non-responsive*	*Qualified but needs more nurturing (linked to Prospect)*	*Lost opportunities (ongoing nurturing)*

The final step in defining your revenue stage model is to define the business rules that specify when a lead moves from one stage to the next (including how leads move from Detour Stages back to the Happy Path). For example:

- A person may move from “Review New Names” to “Prospect” if they have revenue above $100 million a year and are in one of the target industries
- A “Prospect” may move to “Lead” when the lead score goes above 100 points
- A “Prospect” may move to “Inactive” if they have not responded to any campaigns or visited the website in more than six months
- Any leads in “Inactive” may move back to “Prospect” if they respond to a new program

A note about Marketing ROI calculations: Modeling your revenue stages also provides a great framework for measuring marketing results. By measuring and reporting on the number of leads and accounts that enter each stage in a given period, the CMO can discuss marketing results in a rigorous way that shows how lead generation and lead nurturing activities are impacting revenue.

2. Specify Your Lead Types

With the structure of your revenue stages in place, the next step is to define the various types of leads that you will want to track. This is important because different types of leads will move through the revenue stages differently; some will have better conversion rates than others, some will convert faster than others.

Some examples:

- **Lead source:** Leads generated from pay-per-click will usually convert faster than leads from purchased lists.
- **Company size:** Leads from large enterprises may convert more slowly than SMB leads.
- **Division:** Whether your divisions are by geography, business unit or both, the leads from each division will likely behave differently.

Other examples might include industry, product line, and channel source.

Understanding these differences is essential to help you roll-up accurate forecasts from each type.

3. Measure Revenue Stage Conversion

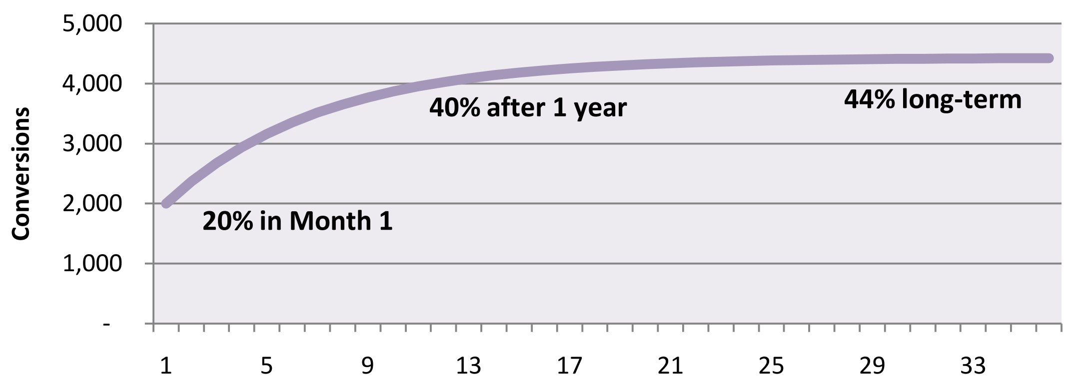
At the core of your marketing forecast is an accurate understanding of how each lead type moves through the various revenue stages in terms of conversion percentage and velocity.

This is a straightforward exercise for Gate and SLA stages, since it is easy to know when to measure the conversion rate. A Gate stage conversion happens instantly, so the conversion rate for any period is simply the number of leads that passed the gate divided by the number that entered the gate. For an SLA stage, wait until after the SLA time is met to make the measurement; for an SLA of 14 days, you can measure an accurate conversion as long as you do it 14 days or more after the period is over.

On the other hand, the calculation for an Inventory stage is significantly more complicated. Because leads can sit in the inventory pool for an indefinite period, you need to consider time when thinking about conversion. Any calculation that does not properly reflect this will suffer from inaccuracies and distortions. Here is one way to do it right:

- First, take all the leads that enter an inventory in a given month (or quarter) and measure the percent that convert down your “happy path” within the same month. This is a measurement of the quality of the incoming leads.
- Second, take all the leads that are sitting in the inventory at the beginning of the month and measure the percent of those that convert in a given month. This is a measurement of your nurturing effectiveness.
- Third, repeat the calculations for detour stages such as “Inactive” or “Lost”.
- Finally, combine all the results to estimate the number of leads that will be left in the inventory at the end of the period. Then you can repeat the second and third calculations projecting forward to estimate what conversion looks like over time.

For example, consider the conversion from the “Prospect” inventory to “Marketing Qualified Lead”. Assume that 20% of incoming Prospects are fast movers and convert to Lead within the first month, and no Prospects go inactive the first month. Also, assume that in any given month 5% of the Prospect inventory gets “hot” and converts to Lead, but that 10% of the remaining inventory also transitions to detour stages, such as “Inactive”, each month. If you start with 10,000 new prospects in Month 1, their conversion to Lead will look like:



Understanding the shape of this curve for each Inventory stage and each lead type is essential for making accurate marketing forecasts.

<u>A note about Marketing ROI calculations:</u> Measuring how these conversion rates vary by type is a great way to measure marketing effectiveness. For example, do leads from certain sources convert better than other sources? If so, perhaps you should invest more in those.

In addition, tracking how the rates change over time is a great way to monitor marketing performance. If the percent of fast movers is declining, perhaps it is a sign of deteriorating lead quality. If the percentage of leads converting out of inventory increases, perhaps you are doing a better job keeping leads engaged with nurturing.

4. Get Accurate Inputs

As with anything, marketing forecasts are subject to the rule of “garbage in, garbage out”. You will need an accurate estimate of how many new leads will flow into the system in any given period, by type, to serve as the fuel for your revenue engine.

5. Model Flow through the Revenue Stages

The final analytical step in the process is to project everything forward by taking your existing and new leads and modeling how they will convert through the various revenue stages over time. If your understanding of conversion rates and inputs are accurate, you will create a solid projection of what the revenue funnel will deliver in future periods.

6. Review Results and Apply Management Judgment

Of course, the numbers returned by the model are just estimates and assume that conversion rates will remain steady over time. The actions of the marketing and sales teams can and should affect the conversion rates – positively or negatively – and this needs to be taken into account. That is why it is essential for the marketing executive to review the output of the model and apply executive judgment before finalizing the forecast.

Furthermore, just like the sales function, CMOs at larger companies will need to “roll-up” the marketing forecast from multiple divisions (product, geography, etc.) when coming up with a final, top-level forecast. Based on prior experience, this may involve adjusting the forecast, such as lowering the forecast from divisions that habitually overestimate their results.

Any CMO making marketing forecasts should be rigorous about the difference between “Commit”, “Target” and “Forecast”.

- **Commit** is the number that the CMO can guarantee and should not vary frequently; this is number to use as the basis for the CMO’s quota / bonus.
- **Target** is a number higher than ‘Commit’ which reflects what the team should be aiming for. The goals for individual groups should roll-up to meet the overall Target, not Commit.
- **Forecast** is the CMOs best estimate for what will *actually* happen and should float based on the most recent estimates and adjustments. This may be higher, or lower, than Commit and Target at any point in time.

CMOs that track and communicate progress against these three metrics are sure to build the credibility they deserve. One way to present these metrics is via a waterfall chart. For example:

Marketing Forecast	-4	-3	-2	-1	Cur	+1	+2	+3
Commit	76	79	82	82	85	88	92	94
Target	80	83	86	89	91	94	97	100
-4	80	83	86	89				
-3		85	86	84	86			
-2			95	86	86	90		
Previous Month				86	88	94	97	
Current Month					91	95	98	103

Commit	Target	Forecast	Actual

Number of New Customers by Month

This type of presentation is useful to show actual results compared to forecast and plan, as well as how the forecast changes over time. The example shows actual results for the current month and a forecast for the next three months; it also shows the forecasts from the prior four months compared to actual results. This presentation can also illustrate the forecast for other revenue stages such as new prospects, marketing qualified leads, even closed bookings.

Trust, Measurements, and Incentives

The second requirement for successful marketing forecasts is the right set of measurements and incentives to encourage trust, accuracy and accountability.

The most important factor is to create **trust in the forecast**. If fellow executives do not trust the marketing forecast, there is no credibility benefit for the CMO.

You can tell there is trust in a forecast if the company is comfortable taking action on it; if the forecast is not actionable, it is just data. This includes authorizing new investments, hiring additional staff or delaying planned hires, and adjusting manufacturing and inventory plans based on the forecast.

Of course, it takes time to build trust in the forecast and repeatedly "calling the number" accurately is the best way to do this – but having the right measurements and incentives helps as well.

Perhaps the most important step you can take to ensure trusted, accurate forecasts is to reward honesty. Some people may be unrealistically optimistic and over-forecast, but even more common is the tendency to sandbag so the results look like "good news". While over-forecasting creates well-understood problems (e.g. missing the number), under-forecasting creates problems as well, such as not having enough capacity or inventory to deliver on what is sold.

The key is to focus on honesty and accuracy and not to "shoot the messenger" if the forecast does not look good. For example, some companies add a 10% increase to the bonus for being within ±5% of the forecast, even if the results are below plan, and they penalize with a 10% deduction from the bonus for having a forecast that was off by more than 10% in either direction.

Finally, accuracy is not the only metric you can use to judge a forecast. According to sales forecasting company Right90, you should consider three metrics in addition to forecast accuracy:

- *Forecast Completeness:* How many forecast inputs have been updated in a specified period? This tells you if people are following the process or if you are seeing stale data. This metric can be especially useful for driving behavior change early in the implementation of forecasting.
- *Forecast Bias:* The positive or negative variance between actual results and forecast, e.g. does the forecast tend to be over or under actual results? This tells you what kind of management adjustments you may want to make to the forecast.
- *Forecast Consistency:* This is a measurement of the forecast variance (standard deviation) over time. A bias of -20% one month and +30% the next is not as consistent as bias of +30% both months. This can also help you to make judgments about how to adjust a forecast.

Tools

Like sales forecasts, marketing forecasts can be difficult to manage without the proper tools. Virtually 100% of all marketing forecasts today are created via spreadsheets, a practice that is subject to errors and doesn't easily scale to handle the complexities of multiple lead types (e.g. different models for different kinds of leads) and divisions.

Instead, CMOs need an application that is purpose-built to deliver the rigorous analytics they need to measure and forecast the impact marketing is having on revenue. The right application must:

- Be easy enough for CMOs and their key staff members to use without requiring dedicated a marketing analyst, but robust enough to handle the complexities of today's sophisticated revenue cycles
- Integrate with marketing automation and sales force automation systems to minimize duplicate data entry
- Present forecast information and actual results to allow for accurate comparisons
- Provide historical views and trend information over time, not just current data
- Support executive dashboards to communicate forecasts and actual results

Conclusion

As buyers use online and social resources to take control of their research, they are engaging with sales later and later in the buying cycle – and this makes it harder than ever for sales to make accurate long-term revenue forecasts. However, it also means that the marketing function has more visibility than ever into the early stages of the revenue cycle and is in a great position to forecast future revenue results.

CMOs that use analytical rigor and a deep understanding of how prospects move through the revenue cycle to make accurate revenue forecasts are in a great position to demonstrate the impact marketing activities have on revenue, justify and protect their marketing budgets, and increase their personal power and credibility in the organization.

About Marketo

Marketo is the revenue-focused marketing automation company, revolutionizing how marketing and sales teams of all sizes sell and succeed at every stage of the revenue cycle. Delivered in the Marketing Cloud, Marketo's powerful and easy solutions provide the fastest time to value and ignite explosive revenue growth from the earliest stages of demand generation and lead management to the pursuit of revenue and customer loyalty.

Marketo Lead Management helps Marketers acquire, nurture and qualify more high quality sales leads with less effort, while Marketo Sales Insight helps Sales understand, prioritize and interact with the hottest leads and opportunities to close business faster. Known for providing breakthrough innovation and the utmost in usability, Marketo was voted 'Best Marketing Automation Application' and 'Best Mass Emails Solution' by Salesforce customers on the Force.com AppExchange. As of February 2010, more than 450 enterprise and mid-market clients in 14 countries have selected Marketo.

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