

Marketing ROI : balancing the art and science of marketing

The most relevant marketing measure to the CEO is the return on their marketing investment. A Marketing ROI system can deliver significant benefits in terms of better decision-making and allocation of marketing resources.

About InsideOut

InsideOut is a growth consultancy focused on developing businesses through the application of specialist strategy, marketing, sales, online and finance expertise

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"One half of my advertising budget is wasted. The trouble is, I don't know which half."
John Wanamaker

Introduction.

Marketing is often seen as a blend of art and science. However, too many marketers focus on the art end of the spectrum, endlessly trying new things in the hope that something will work. Unfortunately as business gets tougher and CEOs get more demanding this approach just isn't working anymore.

To ensure they have the respect of the executive team, marketing managers need to speak the language of CEOs. Almost all CEOs are focused on profitable revenue growth, so identify the key initiatives that will deliver profitable growth and then find the tools to measure the results. Don't forget the art, just don't always lead with it. By being analytical, measured and objective as well as creative, the executive team will be more likely to support new marketing projects.

Key challenges to deliver value in the marketing department.

Before introducing Marketing ROI it's important to ensure the marketing team are focused on the right challenges. The five challenges below provide a context to think about whether the marketing team are delivering the most value possible. These challenges are from CMO Magazine and they help put the focus on ROI in perspective. A marketing approach ROI is never going to lead to a dynamic vibrant marketing culture. It has to exist in an environment with passion, commitment and strong values.

Key Challenges;

1. **Define value in terms that the CEO would value.** Agree the key objectives that are supported by the executive team and deliver tangible benefits to the organisation. Clearly define how marketing adds value, identify a few key, high-level marketing priorities, and link these priorities to the company's growth and profitability objectives.

2. **Earn credibility through customer expertise.** Aside from marketing skills, understanding customers better than anyone else earns a seat at the executive table. This customer understanding should drive everything marketing does. Be careful not to outsource this to research firms completely. To really know customers it's important to get in front of them and understand their lives.
3. **Focus on the customer experience.** Marketing needs to take ownership of every part of the customer's experience. It's not just the latest deal, package or promotion that's important, but innovation across the whole experience, across all channels, from the initial enquiry to the return home.
4. **Think in process terms.** Marketing should be structured around processes not traditional functional activities such as pricing, promotion or product. Think understanding, defining, delivering, communicating etc, each process has a set of activities and deliverables, these processes together should constitute the new focus of marketing.
5. **Create a value/ROI culture.** Marketing must conform to the adage, "If you can't measure it, you can't manage it". Marketing Managers need to promote a return on investment mind-set that permeates every marketing initiative. Marketing initiatives need to be derived from marketing objectives, and marketing initiatives need to be evaluated on a set of objective metrics. In simple terms, marketers need to define where they want to go (objectives), how they will get there (strategy), what it will take to get there (resources), and the tools to measure the results (metrics).

Implementing an ROI culture doesn't mean every single project must be quantified. But every project needs to support the overall objectives, they must add value to the high-level metrics and it should be conceivable that they will generate a return to justify the spend. If it smells like a pig and looks like a pig, then it probably is a pig – some common sense and deduction is allowed!

Benefits of implementing an ROI system.

The most relevant marketing measure is the return on your marketing investment. While it is important to have increasing customer satisfaction or awareness in the market place, at the end of the day it is the amount of profit generated, for the marketing investment made, that is important. ROI can be managed to account for long-term or short-term initiatives and can be used to steer marketing investments.

Key benefits;

- Faster decision making with a standardised process for assessing investments

- Improved shareholder value as marketing budgets are spent on greater profit opportunities
- Faster growth opportunity with greater profits
- Better learning of success and failures with common measurements
- Demonstration of measurable value from marketing budget – no longer a discretionary expense.

Current adoption is low.

Jim Lenskold found in the “2006 Marketing ROI and Measurement Trend Study” that despite a significant increase in marketing’s ability to measure financial impact, only a minority of businesses are successfully measuring and improving their marketing ROI. The key issue is improving marketer’s financial skills and their understanding of measurement methodologies.

Total ROI framework.

A total ROI framework takes into consideration corporate, marketing and campaign measures. At the highest level corporate success is all about profitability. At a marketing management level, people often refer to the bundle of metrics that needs to be monitored, as a marketing dashboard. To design a full marketing dashboard it’s important to consider the right mix of metrics that reflects marketing success in your business. Appendices 1 & 2 illustrates a full dashboard measures and ROI framework. The next three sections discuss how to use the framework at the corporate, marketing and campaign levels.

1. Corporate Level - Key ROI formula.

At the corporate level, marketing activity can be measured using the single Marketing ROI metric. The basic ROI formula is;

$$ROI = \frac{\text{Return}}{\text{Investment}} = \frac{\text{Gross Margin} - \text{Investment}}{\text{Investment}}$$

The **Gross Margin** is the present value of incremental profits less cost of sale expenses. This represents the contribution made to the company’s profits prior to deducting the marketing investment.

The **Marketing Investment** includes all the expenses that are put at risk to market the product or service. This includes campaign development and media, as well as staff time allocated to managing the project. It does not include additional discounts or gifts – this is a cost of sale.

Key things to understand

- ROI should be a positive number and expressed as a percentage. A positive percentage is a financial gain, a negative percentage a financial loss and 0 is breakeven. A hurdle rate greater than your cost of capital should be set. Ask your finance team to help.
- Return should be based on the Gross Margin Contribution – not Revenue.
- It should include a reasonable estimate of Incremental Customer Value (ICV) – this is the subsequent sales the customer will make as a result of the initial purchase. Note though this is not Customer Lifetime Value (CLV) – Lifetime value requires further reinvestment from future marketing investments – so using CLV will overstate the return.
- Don't include any costs of sales in the investment – discounts, vouchers, and incentives, are COS items not investments. That is you incur the cost with the sale, not with the generation of the marketing program. Typically variable costs are COS and fixed costs are an investment.

2. Marketing Level – Extending the Marketing Maths.

At a marketing level, marketing metrics are not limited to ROI alone. There are two other key concepts that need to be considered. These are Investment Limits and Marketing Allowables.

Investment Limit. The investment limit is the maximum amount that can be invested to get one new customer. It's useful to know this number, not just for marketing but also for new sales or account recovery situations. The formula is;

$$\text{Investment Limit} = \frac{\text{Projected Incremental Value (ICV)}}{(1 + \text{ROI Threshold})}$$

This is simply the projected incremental value (ICV) of one customer divided by 1 + your ROI threshold rate. So for example if the ICV value was \$450 and the ROI threshold rate 25% the calculation is;

$$\text{Investment Limit} = \frac{450}{(1 + .25)} = \$360$$

So a spend of \$360 to generate one new customer, who will contribute \$450 of Gross Margin to the business, will generate a return of 25%.

Marketing Allowables. While the investment limit is the amount that can be invested to get one new customer in a campaign, an allowance needs to be made for the expected conversion rate. That is, with a 100% conversion rate \$360 could be spent per prospect, but in the real world it's almost always impossible to achieve that. So the Marketing Allowable is the amount allowed per prospect in a campaign. The formula is;

$$\text{Marketing Allowable} = \text{Investment Limit} \times \text{Expected Conversion Rate}$$

So simply multiply the Investment Limit by the expected conversion rate and this is the Marketing Allowable figure, the spend allowed on each prospect in a campaign. So for example, if the calculated Investment Limit is \$360 and the expected conversion rate is 2%, the calculation is;

$$\text{Marketing Allowable} = \$360 \times 2\% = \$7.20$$

So you would be prepared to spend \$7.20 per prospect in a campaign that will expected to generate a 2% conversion rate, where the investment limit was \$360.

The full circle. Now that we are clear on these calculations we can consider the full marketing cycle and understand the decisions we are making at each stage of the marketing cycle;

- $\$7.20$ per prospect x 10,000 prospects = $\$72,000$ Investment
- 10,000 prospects x 2% conversion rate = 200 customers
- 200 customers x $\$450$ value per customer = $\$90,000$ NPV Gross Margin
- $\$90,000$ Gross Margin - $\$72,000$ Investment = $\$18,000$ Return
- $\$18,000$ Return / $\$72,000$ Investment = 25% ROI

Other strategic marketing considerations;

Long term versus short term activity. One thing business needs to do is build long-term brand equity. This is achieved through brand building, awareness advertising, or building associations through sponsorship for example, while these activities will result in sales they are not designed to generate them immediately. As a result it is not realistic to judge these results against tough ROI measures. Brand communications should be considered an overhead expense and managed using long-term brand equity valuations. Considering this, obviously a judgement needs to be made in terms of what proportion of the marketing budget should be allocated to brand building.

Bankable success versus innovation. In business it's critical to continually innovate and become more successful, while at the same time it's essential to recycle those methods that are tried and true. From a marketing point of view while there's always a desire to be innovative, this has to be balanced against the risk of a complete campaign failure. To manage this it's important to set a portion of the budget aside for innovation and experimentation so you can learn and improve the results. However the key is to set this not so high that it might adversely affect the annual results should these campaigns fail to generate an adequate return.

Expected ROI versus existing returns. When starting the Marketing ROI journey, typically you will be pleasantly surprised at how marketing is contributing to the business. However sometimes the reality is that the marketing activity is eroding value. In either case, the key is to focus on incrementally improving the returns. Where the return is already positive a case can be made to justifiably expand the budget. Where the return is less than acceptable it's important to put in place a framework to review, test and improve the returns or contemplate reallocating the budget.

Building on a new concept. Another thing to remember is that sometimes the first iteration of an idea doesn't work as well as it could. This doesn't mean it should be scrapped, if there is confidence in the concept, look to significantly improve the campaign by altering the mix; the offer, creative, media, target/prospects etc.

3. Campaign Management.

It's important to look for a greater return out of every campaign you do. There are many ways to do this. Different campaigns have many elements; target customers, product, creative executions, offers, media mix, and timing. Each of these different elements can be altered, giving a significantly different result. However by using ROI fundamentals to review every campaign it will be possible to select better concepts and generate an improved return on investment.

Key questions in campaign management are;

Planning - What campaigns can be developed within investment limits? Use ROI framework to better plan the marketing budget and set budgets according to what is realistic rather than basing the budgets on historical levels.

Selections. What concepts should be tested on the likelihood of exceeding the ROI threshold? Looking at specific campaign ideas, it should be easier to make a judgment as to whether they will generate the required return. If there isn't confidence that the campaign will work, look to see how to improve the concept or go back to the drawing board.

Testing. How can we roll out and test different campaigns to maximise learning? When planning the annual budget, look to build in different concepts to learn new things as the year progresses. Look to make smaller investments on the new ideas, and plan to roll these out if they are proved successful.

Measurements. How will the results be measured? What indicators can be used to project customer value and campaign results? Obviously the ROI for each campaign will be measured, but there will be other measures of campaign success. Some of these will be more subjective than others. The key is to discuss and review what metrics will be collected before the campaign begins and where necessary ask the IT department to build the reporting into the system. Don't leave this until the campaign is underway or finished.

Review. What campaign strengths and weaknesses are identified through post campaign metrics and review? It's important to sit down as a team and spend an hour to review what worked, what didn't and how to make the campaign better. Take the time to do this and write down the key learnings to improve the results next time.

Measurement Considerations.

Once the measures are decided, obviously systems have to be put in place to collect the results. Naturally this needs to be done as automatic and painless as possible. There are three different types of ways of measuring. These are;

1. **Direct Measures** – directly measure the specific indicator, for example unit sales and value.
2. **Controlled Testing** – complete a test campaign and measure the results versus a control group. Here the test results are used to predict an outcome. It is not as accurate as a direct measure but there is value in completing a small test to validate a new campaign prior to rolling it out.
3. **Benchmark Assumptions** – complete some research to estimate a value. A specific example where this could be done is to calculate the Incremental Customer Value. Here customer spending trends and levels could be analysed, as well as customer database values such as frequency and recency of spend, to provide an estimate. Also quantitative research could be used to find out share of spend values.

Media Measurements

Different styles of communication have different levels of measurability. Brand advertising is difficult. Traditional media is possible to measure but not perfect. Direct Marketing is easy to measure and Online Marketing offers the ultimate in measurability.

Looking specifically at traditional media; TV, Press, Radio, Billboards. While this is difficult to measure mechanisms can be build into the advertising to do this. Ideas to be explored are;

- Different 0800 numbers
- Different URLs
- Website/retail questioning
- Txt for info
- Specific Coupons/Offer

4 key steps to get an integrated ROI system.

1. Build a marketing plan with ROI measures that align with business **objectives**.

Understand each element of the marketing plan and assess the impact this will make on an ROI basis. Not every marketing activity drives incremental sales, so consider each activity in conjunction with your sales funnel; unaware, aware, prospect, qualified prospect, customer, advocate. State what the plan accomplishes on it's own and how this contributes to business performance.

2. Understand ROI scenarios to develop a successful **strategy**.

Compare all of the marketing activities to understand the relative value of the different marketing activities. Run different scenarios to understand how changes to the target market, marketing mix, offers and investment level, lead to changes in potential profits. There is a need to balance both short term and long term activities and proven marketing activities (low risk) with new innovative activities (high risk). Think in terms of balancing a portfolio.

Estimates will need to be made. Smart marketers make their estimates and assumptions as realistic as possible. Just going through this exercise will help you understand and adjust your marketing decisions. Plus it will also highlight any information gaps in your planning.

3. Better understanding to **execute** campaigns.

One of the reasons planning is often so painful is that there isn't enough information to make good decisions. As painful as it is to pull money from productive budgets into research budgets, sometimes this has to be done. No doubt there will be some information gaps, so build some extra questions into any upcoming research to build your knowledge.

4. Better budgets and success **metrics**.

The corporate planning process can bring out the worst behaviours in the management team; each manager looks to protect his or her own budget. Finance seeks to push managers to achieve more with less and managers look to under commit and over perform. Marketing is especially vulnerable as it is seen as a discretionary spend. An ROI framework will help to provide a more objective basis for discussion, which should lead to better budgets and more measurable results.

Conclusion.

Marketing metrics is a simple concept; at the heart of it is the need to generate a return that justifies your expenditure. Everything doesn't have to be introduced at once. Spend time getting used to the ideas and introduce them campaign-by-campaign. When annual budgeting time rolls around, look to apply the principles in the planning process. Look at the different areas in the marketing team and see how the ideas work there, each area will be different. But make sure to use the same definitions in each area so everybody talks the same language.

Once the ROI fundamentals are understood, you will start to take a more rigorous approach to your marketing. Over time a more disciplined approach will develop, one where questioning, testing and learning become standard core competencies. When this happens you should realise a dramatic improvement in your Marketing ROI.

Moving Forward

To take a new approach with your marketing go to www.inside-out.co.nz for more tools and information. We offer a Marketing Effectiveness programme to help you transform your marketing results. This includes a marketing audit, budget review, lean marketing workshop, key supplier review, and a Marketing ROI training presentation. This programme can be tailored for the size of your business.

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Appendix 1. Suggested Dashboard Metrics

Metric	How measured?
Awareness	Research – Annually
Advocacy	Online Research – via email after customer purchases.
Campaign Response Rates	Campaign by Campaign – aggregated by media type – ie trad, direct, online
Cost per sale	Campaign by Campaign – aggregated by media type – ie trad, direct, online
Website Visits	Key measure of overall interest in brand. Driven by all media activity.
Productive v non productive costs	Accounting measure of revenue generating marketing activity compared to overhead costs.
Productive v Salary costs	Similar measure but just looking at revenue generating marketing costs compared to salary costs. Can vary drastically depending on type of business.
Active Customers	Number of active customers in Database. By active, could be defined as have purchased in last 6 months.
Customer Loyalty	Average length in years, from initial purchase to most recent purchase of current active customers
Average Sales Value	Average sales value of active customers over last period
Lifetime Value	For Active Customers – total active customer value divided by # of active customers.

Metric	How measured?
Change in Segment Customers	If looking to change mix of customers - % of active customers in each segment

Appendix 2. Full ROI Framework

