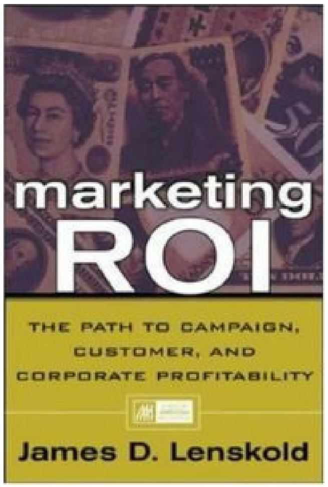

Book Marketing ROI

The Path to Campaign, Customer, and Corporate Profitability

James D. Lenskold
McGraw-Hill, 2003

Recommendation

In the past, marketing professors often taught that companies could not hold their marketing managers responsible for the success or failure of promotional programs. Numerous external variables that these managers could not control – including delivery problems, poor retail displays, sales slumps, competitors' moves, buyer psychology, and so on – could undermine their outcomes. Marketing managers were off the hook when it came to results, particularly return on investment (ROI). Times have changed. Today, every corporate dollar matters and companies demand accountability from their marketing professionals. If a promotional program doesn't work, its manager will quickly be out of a job. Strategic marketing consultant James D. Lenskold provides his tactics for calibrating marketing ROI, plus a basic "marketing ROI formula" you can use (with variations and, perhaps, some hands-on expert help) to quantify the returns you derive from your marketing efforts. Though his mathematical formulations can be daunting, his accessible work explains a logical methodology for measuring marketing programs' results. Thus, *BooksInShort* recommends this practical book to CEOs, CFOs and all marketing executives.

Take-Aways

- Marketing is an investment that should make a profit. To express the percent of earnings on your promotional campaign, find your marketing "return on investment" (ROI).
- ROI is the most concrete financial basis for planning a marketing campaign.
- The benefits of knowing your marketing ROI include well-informed decisions, better earnings, higher marketing budgets and an improved competitive posture.
- The very basic "marketing ROI formula" is: "ROI = Return ÷ Investment = (Gross Margin – Marketing Investment) ÷ Marketing Investment."
- Your investment is your marketing expenditure. Your return is the financial gain it earns.
- Your marketing ROI will be meaningful only if your data are reliable.
- Your gross margin, which requires computing net present value, is a "flow of income and expenses over time."
- Calculating marketing ROI requires having measurable business results. Otherwise, there is no way to assess how effective your marketing effort turned out to be.
- Companies can set a marketing "ROI threshold" to prequalify a marketing program.
- However, this threshold must be flexible and will be different "for strategic planning" and "for performance measurement."

Summary

Real Returns: Always Important, Now Critical

Think of marketing not as an expense, but as an investment for which you expect a favorable return. Otherwise, why spend money on it? Some executives think that projecting a reliable return on investment (ROI) for marketing isn't possible and believe that no one can quantify "marketing ROI" in hard financial terms. Yet businesses routinely demand precise ROIs for expenditures on plants and equipment, as well as complex technology initiatives. So why not marketing? Given that nowadays accountability is king, heed these basic marketing ROI principles:

- **"ROI is the ultimate measure for guiding marketing investments"** – A sound, sensible, "strategic and tactical marketing decision" requires a reliable ROI metric.

- **“Marketing ROI is unique”** – Unlike large capital investments, your overall marketing expenditure depends on numerous “small investment decisions.” ROI is a refreshingly straightforward measurement of financial return in relation to marketing expenses.
- **“Marketing ROI must be a primary [competitive] measure”** – How you spend your marketing dollars and what returns they generate will affect your competitiveness.
- **“Marketing ROI is most beneficial with executive level involvement”** – Leaders must be committed to making ROI thinking part of marketing’s budgeting procedures.

> “It is reasonable – in fact, beneficial – for executives to expect a measurable return on marketing investment.”

Marketing ROI provides invaluable planning and “performance analysis” intelligence that companies can use to justify strategic marketing decisions and expenditures. Firms that operate without such crucial information are asking for trouble. For instance, as the 2001 holiday season began, Kmart cut its ad budget by about half while starting a new discounted pricing program. This unenlightened decision produced dismal sales. Within months, Kmart filed for bankruptcy.

> “Profit is the goal, ROI is the measure.”

The benefits of using the ROI-based approach to marketing include the ability to make decisions quickly and with better outcomes. Having your marketing ROI figure gives you deeper information about the advantages or disadvantages of your tactics, as well as more insight about your earnings, shareholder value and the profitability of your marketing strategy. Companies with marketing ROI numbers are better equipped to build “purchase volume” and “purchase frequency.” Plus, with superior targeting, they can reduce their marketing expenses and more intelligently prioritize their marketing resources.

Challenges of Implementing a Marketing ROI Program

Establishing an accurate ROI metric for marketing poses numerous challenges, including:

- **“Generating reliable future value projections”** – The way consumers will act in the future is unknowable, so predictions are, of course, imprecise.
- **“Getting access to data”** – Your firm will need to track the discrete data required, such as “immediate purchases, future purchases, future customer service expenses, retention rates and referrals.” Then it will have to be willing to give the information to marketing.
- **“Standardizing measurements, values and practices”** – If each marketing group in a corporation uses its own unique ROI formula, standardization will be impossible.
- **“Establishing cost-effective measurement processes”** – Companies may decide to invest in marketing research but not in performance measurement.
- **“Establishing valid control groups”** – This just isn’t possible in certain mass marketing programs. In some instances, you can’t measure consumer behavior accurately.
- **“Allocating expenses”** – Budget for “creative and development costs” but don’t let their costs impede your program development activities.
- **“Understanding residual value”** – ROI measures don’t calculate payments toward future marketing programs.
- **“Organizational barriers”** – Cultural considerations and embedded routines, from existing compensation plans to fear of change, often impede ROI innovations.

The ROI Formula

At its core, ROI equals return divided by investment. “This is the ROI formula in its most basic form: ROI = Return ÷ Investment = (Gross Margin – Marketing Investment) ÷ Marketing Investment.” Practitioners often customize this formula “for use in marketing” and its application requires considerable expertise and data. The basic elements needed to derive ROI are:

- **Marketing investment** – This is the total of all your marketing expenditures on the campaign for which you are calculating a return.
- **Return** – This is your financial gain “beyond the initial investment” for marketing.
- **Gross margin** – This is a “flow of income and expenses” over time, showing sales revenue minus the cost of sales and the cost of production. It indicates “the present value of incremental profits and expenses in the calculation of return,” that is, profits before you deduct the expense of marketing.

> “Marketing ROI analysis can scale from the incremental value of a tagline on an envelope to the implementation of a multimillion-dollar enterprise CRM marketing initiative.”

Calculating an accurate gross margin requires corporate financial data, particularly the “time value of money,” or “net present value” (NPV). This is a discounting factor because businesses deem current profits more valuable than projected profits. If your firm made money on a marketing campaign, your ROI calculation will result in a positive number. If your campaign lost money, the figure will be negative.

> “More data and more processing power allow for more advanced levels of measurement.”

ROI also accounts for “profits and expenses that extend over time,” and has more flexibility than a strict formula might imply. Often, firms strategically calibrate a minimum “ROI level” to use as a yardstick to help them determine whether to make a marketing investment. This is an “ROI threshold” or “hurdle rate.” A firm’s threshold should indicate what level of return it would consider a success. A company that sets a 25% ROI threshold generally won’t invest in a marketing plan that cannot attain that level of earnings. Most firms set a flexible ROI threshold so their managers can maintain a “point-of-decision perspective” and seize immediate opportunities. “To drive the right decisions, the calculations of ROI will differ,” with one “for strategic planning” and one “for performance measurement.”

> “Applying the [ROI] marketing process can create a distinct competitive advantage, allowing you to make smarter decisions on whom to target, how to reach them and how much to invest.”

A marketing campaign is made up of numerous incremental investments of funds the company puts at risk to pay for marketing. A sales increase shows that the risk was worthwhile; a lack of sales growth indicates that the investment did not fulfill its purpose. Companies generally don’t plan marketing investments the same way they plan capital investments. Normally, a capital investment represents a single large decision, while a marketing investment represents numerous smaller decisions over time. To maximize the profits from marketing investments, companies build on "each incremental investment" with more investments – sometimes even if the total exceeds the ROI threshold. Firms can set various ROI thresholds to manage risk and adapt to "stages of strategic development." For example, one way to use projected ROI in the process of planning a marketing campaign is to calculate your return at various "investment levels," to see what expenditure is likely to result in the most profit.

ROI Is Now Easier to Measure and to Use

Increased measurability makes determining marketing ROI more practical than it was in the past. This is particularly true with online marketing campaigns, since it is easy to track "click-stream patterns of web pages viewed and repeat visits." Retail data also is becoming quite comprehensive. Eventually, mobile device data will become as thorough and detailed as web data. Although a great deal of marketing information is available, compiling pertinent, accurate numbers can be challenging. Specialty firms (such as aprimo.com and marketswitch.com) offer advanced technology solutions for tracking marketing expenses and establishing "ROI optimization." Apply these principles to help ROI-based marketing work at your firm:

- **Align your metrics with your decision-making** – Start by meshing your marketing expenses with your returns. Strive to quantify "profit impact" as closely as possible.
- **To measure returns, first identify monetary value** – To compare the value of different marketing investments, determine each program's costs. Of course, some expenses are tricky to measure. While marketing focuses on enhancing earnings, some of its activities (like charitable donations) do not directly affect profits. In terms of ROI, list such disbursements as general business expenditures within "the cost of goods."
- **"Returns and investments should be complete, accurate and fit a total sum model"** – Add all the returns from your incremental marketing investments to derive a "realistic aggregated ROI projection."
- **Use "performance metrics...to estimate financial value"** – You cannot ascribe financial value to such factors as "awareness, satisfaction and loyalty" or "web visits, advertising recall [and] changes in perceptions." These elements have intrinsic value, but they do not have stand-alone monetary worth. Trying to find a practical, measurable way to apply them in ROI calculations is like searching for the Holy Grail.
- **View "residual value...with caution"** – Strategically, your current marketing investments accrue to add value to your future marketing, but ROI does not include future value. Getting a precise current ROI figure depends on aligning your returns with concrete, actual, measurable – and up-to-date – investments.

Implementation and Opportunity

To establish an ROI measurement process for your marketing endeavors, set up a cross-functional project team. Examine your marketing programs to decide how you would use ROI and whether obtaining it is a practical goal. Evaluate your data. High-quality information is a foundational requirement of a meaningful ROI calculation. Plan a complete marketing ROI process overseen by an "ROI control panel" of well-placed executives. Organize a pilot program. Adjust your strategy according to how well the pilot works, where it hits problems and what results it obtains. Plan a phased rollout, including how you will address each customer segment. Treat your marketing budget as an "investment portfolio." Fine-tune your projections and assumptions. The ROI process is not perfect, so strive for regular improvement. To increase your profits on your marketing investments by using ROI metrics, take these steps:

- **"Shift to ROI measures for your next set of campaigns"** – If data is available, evaluate the decisions you have already made about upcoming marketing investments against their ROI analyses. Discrepancies may indicate potentially profitable adjustments to consider.
- **"Make any necessary corrections to existing ROI measures"** – Common ROI analysis mistakes include incorrectly substituting "revenue...in place of gross margin" or adding the costs of sales to the costs of your marketing investments.
- **"Measure incrementally"** – Each incremental investment should "generate an acceptable return." Do not average results. That can result in flawed analyses and poor marketing decisions.
- **"Automate basic ROI tools"** – Outline your ROI thresholds and use them in planning your marketing budget, so you create strategies that fit your investment targets.
- **"Assess data quality for customer value"** – Informed marketing decisions demand reliable data about the target audience and the potential for "increased customer value."
- **"Develop select benchmark measures"** – For example, calculate the "incremental value" of one marketing outlet as a comparative standard. Researching some benchmarks may be hard or costly, but these markers may help you reach better marketing decisions.

> "The business enterprise has two – and only two – basic functions: marketing and innovation. Marketing and innovation produce results; all the rest are costs." (Peter Drucker)

Using ROI measurement procedures enables companies to apply valuable marketing data in an intelligent manner for a multitude of positive payoffs. Companies can prioritize their marketing expenditures and maximize their profits from marketing, instead of operating blindfolded. Stepping into the ROI light will bring you smarter, more strategic marketing planning and a stronger competitive posture. It will also enhance the stature of your marketing operations.

About the Author

James D. Lenskold heads a strategic marketing firm. Previously, he worked at AT&T, where he helped develop innovative marketing.