

## Class 14 Workshop: Marketing Mix Modeling

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## Section 1

# Marketing Mix Modeling

# Marketing Mix



The illustration features four circular icons arranged in a 2x2 grid. The top-left icon shows three cardboard boxes, representing 'Product'. The top-right icon shows a price tag with a dollar sign and the number '33.33', representing 'Price'. The bottom-left icon shows a computer monitor, a globe, and a storefront, representing 'Placement'. The bottom-right icon shows a megaphone, representing 'Promotion'.

## Marketing Mix

*[ˈmɑːr-kə-tɪŋ ˈmɪks]*

A common classification that began as the four Ps: product, price, placement, and promotion.

 Investopedia

# What is Marketing Mix Modeling

## Marketing Mix Modeling

Marketing Mix Modeling (MMM) is the use of statistical analysis to **estimate the causal impact** of various marketing **mix variables** (especially pricing and promotions) on sales.

- **Core idea:** find an appropriate statistical model that can characterize the relationship (DGP) between sales and marketing mix variables

# Phase 1: Data Collection (What to Include in a MMM Model?)

SAMPLE MARKETING MIX MODEL SALES TACTIC

| DISTRIBUTION & PRICING | PRODUCT               | PAID MEDIA          | PROMOTIONS               | EXTERNAL FACTORS               |
|------------------------|-----------------------|---------------------|--------------------------|--------------------------------|
| Distribution           | Product Life Cycle    | TV                  | Merchandising            | Seasonality & Weather Patterns |
| Pricing                | Product Changes       | Magazines           | Coupons                  | Competitive Factors            |
| CRM & Offers           | New Products          | Newspaper           | Public Relations         | Macroeconomic Inputs           |
| Channel Incentives     | Segment Trends        | Radio               | Loyalty Program Activity |                                |
| Retail Format Changes  | Product Recalls       | Outdoor/Out-of-Home | Event Marketing          |                                |
|                        | Quality Metrics       | Online Media        | Sponsorships             |                                |
|                        | Awards                |                     | Word-of-Mouth            |                                |
|                        | Third-Party Reviews   |                     |                          |                                |
|                        | Sampling              |                     |                          |                                |
|                        | Inventory Levels      |                     |                          |                                |
|                        | Sales Force Activity  |                     |                          |                                |
|                        | Customer Satisfaction |                     |                          |                                |
|                        | Product Performance   |                     |                          |                                |
|                        | Product Placement     |                     |                          |                                |

## Phase 2: Statistical Modelling

- What functional forms and specifications to use for each variable?
  - More of an art than science
  - quadratic terms when **diminishing returns** are expected
- How to determine the “best” model
  - predictive accuracy (error of predicted sales)
  - model fit ( $R^2$ )

# Classic Examples of MMM

**Example 1:** Model the relationship between **sales** and **price** as follows:

$$sales_t = \beta_0 + \beta_1 Price_t + X_t\beta + \epsilon_t$$

**Example 2:** Model the relationship between **sales** and **number of influencers** as follows.

- We would normally consider diminishing marginal return of marketing activities

$$sales_t = \beta_0 + \beta_1 NumInflu + \beta_2 NumInflu^2 + X_t\beta + \epsilon_t$$

## Phase 3: Model-Based Optimization

The outputs from your MMM project – that is, the data and estimates that come out of your statistical model – need to address the profit maximization problem.

- The MMM model will produce a host of outputs that measure how each tactic (e.g., price) affects sales.
- We can then use the outputs to guide our marketing decisions.



## Optimal Pricing to Maximize Profit

- We can utilize the outputs to compute the optimal pricing

$$sales_t = 1000 - 20Price_t + X_t\beta + \epsilon_t$$

- Then we know, conditional on  $X_t$ , the total revenue would be

$$profit = (Price - COGS) * sales = (Price - COGS) * (1000 + X_t\beta - 20 * Price)$$

- We can derive the optimal price to maximize profit.

$$\partial profit / \partial price = (1000 + X_t\beta - 20Price) - 20(Price - COGS) = 0$$

- The optimal price that can maximize the revenue/profit is

$$\frac{1000 + X_t\beta + 20COGS}{40}$$

- In term 2's Operations Analytics module, you will systematically learn how to find the optimal pricing, given the estimated functional relationship between sales and marketing mix variables.

## Section 2

### Zalora Case

## Zalora Case

- Please take out the Zalora quarto document. Let's go through how we can build a marketing mix model for Zalora to optimize its profit.