MASB
Invited Academic Presentation

Defining Marketing ROI

Dominique Hanssens
UCLA Anderson School of Management
Founding Director of the MASB
February 2015
San Antonio

MASB Marketing Accountability Standards Board
of the Marketing Accountability Foundation

Defining Marketing ROI

Authors:

Paul Farris

Dominique Hanssens

Jim Lenskold

David Reibstein

The Implementation Problem of ROI

- ROI is understandably an important metric for managers
- Its roots are in the evaluation of one-time capital projects
- Is marketing a one-time capital project ?
- “Marketers rarely mean ROI when they say ROI” (Ambler & Roberts 2006)
- Exact definition:

  ROI(X) = (Incremental profit due to X – X) / X
- For example ROI(ad campaign) = (400-100)/100 = 3 = 300%

MASB

Two key challenges

1. Trouble with the curve

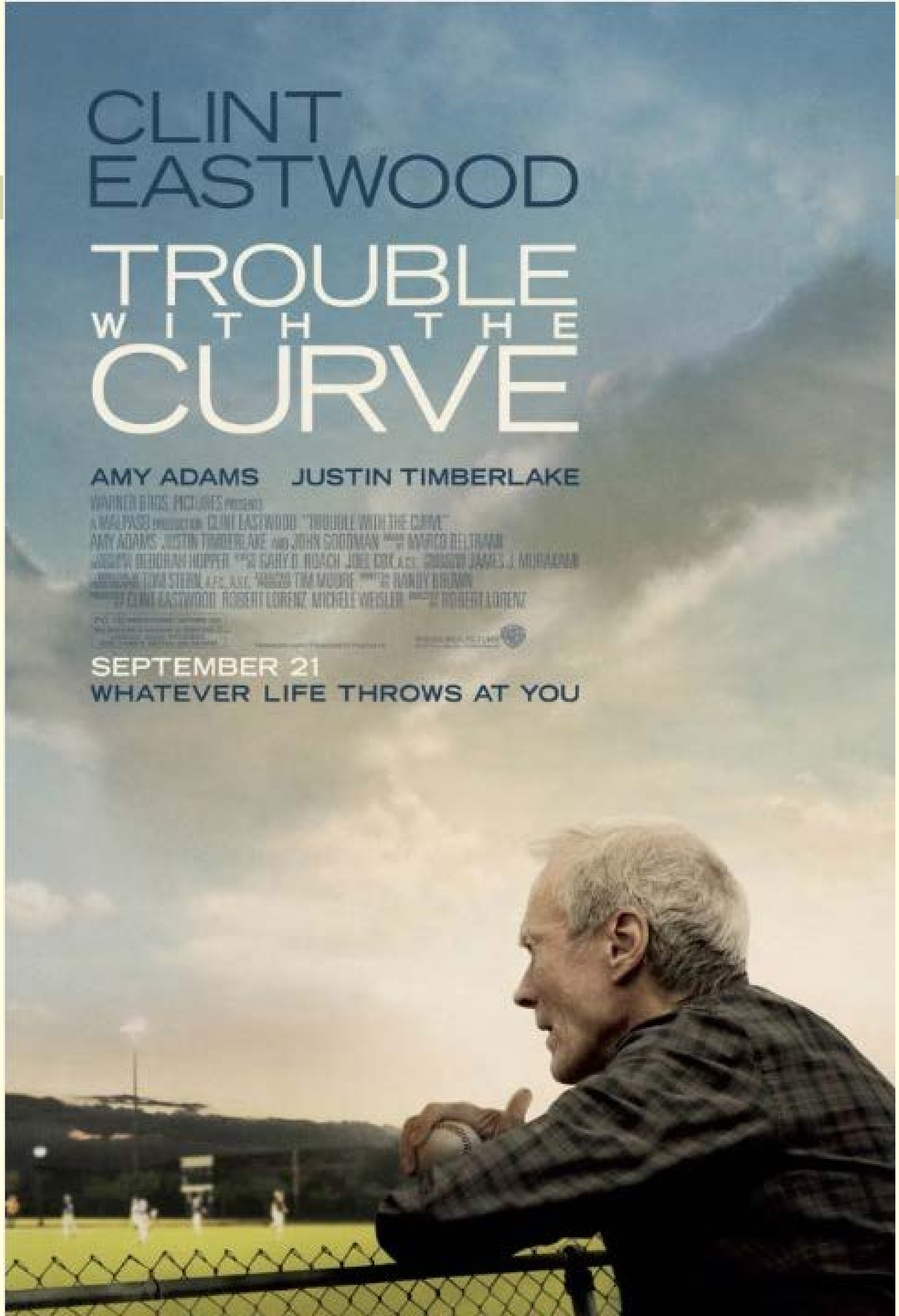
2. Return with respect to what ?

MASB

Two key challenges

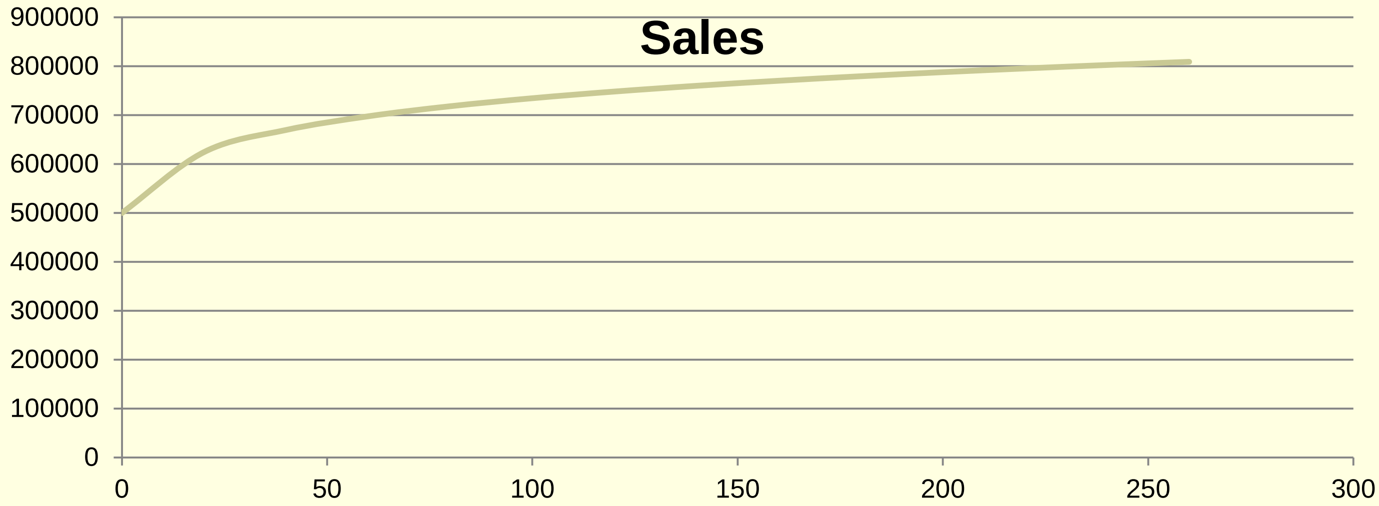
1. Trouble with the curve

MASB


CLINT
EASTWOOD
TROUBLE
WITH THE
CURVE
AMY ADAMS JUSTIN TIMBERLAKE
SEPTEMBER 21
WHATEVER LIFE THROWS AT YOU

MASB

Market Response Curve Illustration



ROI doesn't abide response curves very well

- Problem: law of diminishing returns
  - The greater spend, the lower ROI → underinvestment
  - Okay to compare ROI at equal spending levels
- Problem: division, not subtraction
  - What matters is net cash flows, not ratios
- Problem: no long-term component
  - Replace incremental profit by incremental long-term profit

MASB

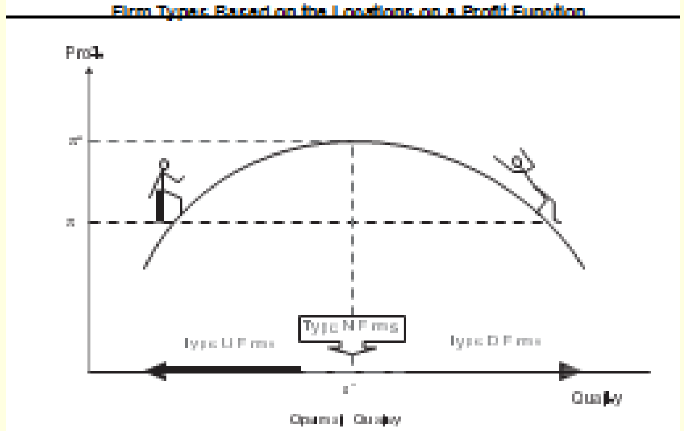
Key: where is our brand on the response curve ?

Mathematically: compare marketing spending with Gross Margin * marketing lift (elasticity)

Graphically: **(Mantrala et al. 2007)**

FIGURE 1

Firm Types Based on the Locations on a Profit Function



MASB

Illustration – compare these ROI scenarios

base	$500,000	(revenue when all marketing =0)		
gross profit margin =	50%			E(digital)=0.04 E(offline)=0.06
Scenario	**Medium**	**Spend**	**ROI**	**ROMI**
Underspend	Digital	$20,000	1036%	36%
	TV	$34,000	851%	21%
Overspend	Digital	$60,000	328%	-52%
	TV	$30,000	1008%	42%
Just right	Digital	$29,000	743%	0%
	TV	$43,000	694%	0%

MASB

Two key challenges

2. Return with respect to what ?

MASB

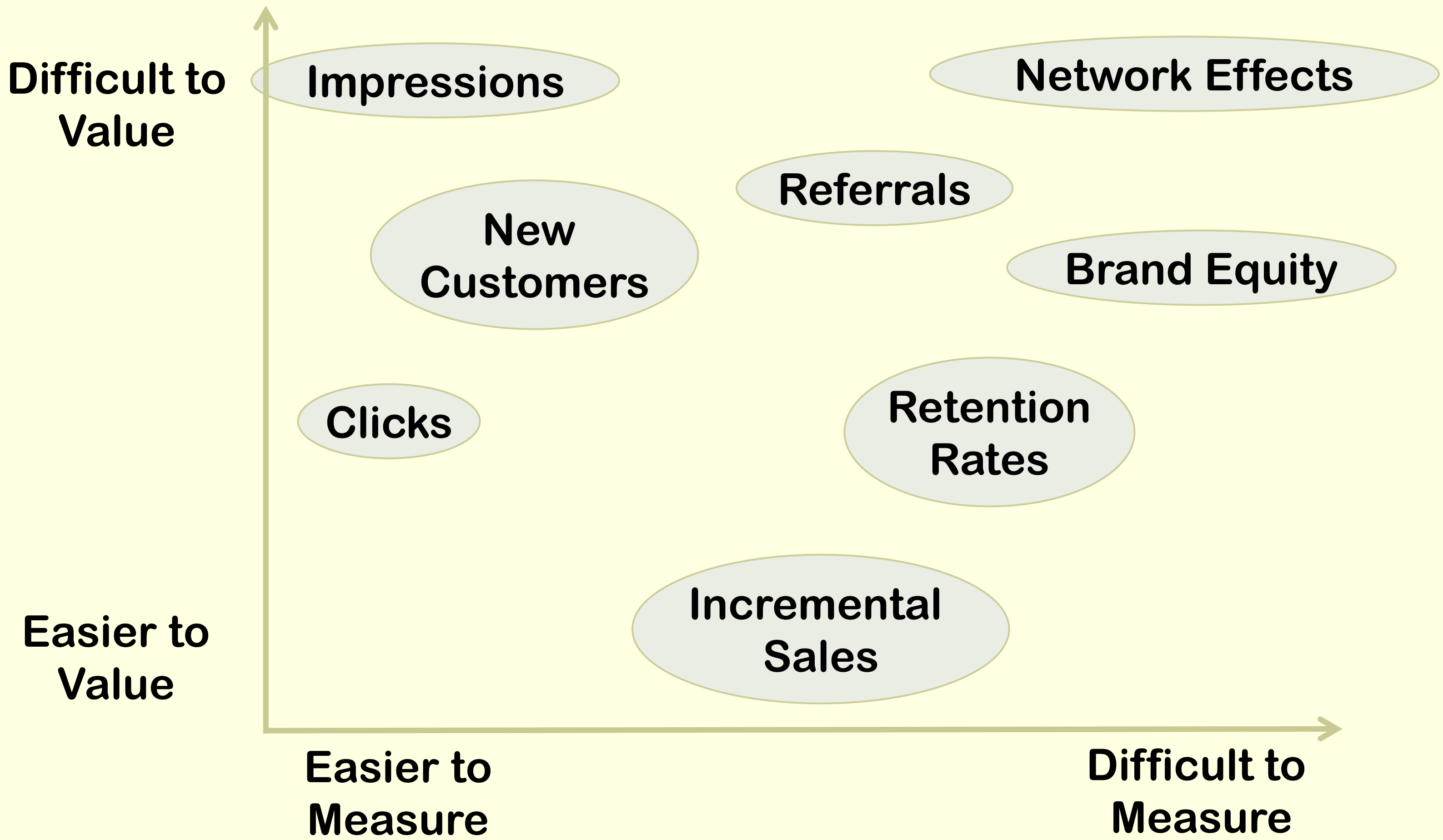
Estimating ROI for Different Marketing Outcomes

More Uncertainty ← Less Uncertainty → More Uncertainty

Exposure	Engagement & Pipeline	Sales, Revenue & Profit	Customer Relationships	Assets & Equity
Typical Metrics for Assessing Marketing ROI				
Exposures, Impressions, Awareness, Sales calls	Clicks, free trials, downloads, "Likes," Tweets, inquiries, leads, web visits	Near-term sales lift, new buyers	Repeat sales, retention rates, cross-sell	Brand/customer equity, channel partnerships, network effects, product platforms
Methods for Placing Economic Value on Metrics				
Cost per contact, correlation to sales	Conversion rates to sales	Incremental margins and profits	Customer Lifetime Value	Future growth potential, balance sheet equity, business valuation

ROI Level & Terms	Approach	Definition
Exposure		
Return on Objective (ROO)	Based on non-financial outcomes	[Briggs formula]
Projected ROI	Based on projected sales from measured marketing outcomes	[Base ROI formula with estimated lift]
Equivalent ROI	Based on media equivalent value	[from Farris book]
Engagement / Pipeline		
Projected ROI	Based on projected sales from measured marketing outcomes	[Base ROI formula with estimated lift]
Return on Objective (ROO)	Based on non-financial outcomes.	[Briggs formula]
Sales / Revenue / Profit		
Marketing ROI or ROMI	Based on incremental sales, revenue and profits	[base ROI formula]
Marginal Marketing ROI or Incremental ROI	Based on sales, revenue and profits from an increment above a base level	[base ROI formula]
Customer Relationships		
Customer ROI	Based on current and future sales, revenue and profits from incremental customers	[base ROI formula with future value]
Assets & Equity		
Return on Assets (ROA)	Based on valuation of assets such as customers, channels, networks, brand, etc.	[various]
Brand Equity	Based on marketing contribution to long-term equity using financial valuation methodologies	[various]

Economic Effects of Marketing Efforts



Example: the value of sales generated from marketing efforts are usually relatively easy to calculate, but deciding what portion of sales are truly "incremental" may be harder to measure with great precision.

MASB

Recommendations

- It is not easy to come up with one “silver metric” for marketing performance evaluation
- Beware blind applications of ROI
- If you must use return measures, use marginal ROI
- Better to categorize in overspend, underspend
- Long-term profitability can be incorporated (Hanssens & Dekimpe 2009)
  - Movement in baseline (permanent) sales
  - Movement in customer equity

MASB

References

- Ambler & Roberts (2006), "Beware the Silver Metric: Marketing Performance Measurement Has to Be Multidimensional," *MSI Reports*, 06-003.
- Farris, Hanssens, Lenskold & Reibstein (2014), "Marketing Return on Investment: Seeking Clarity for Concept and Measurement, *MSI Reports 14-108.*
- Hanssens & Dekimpe (2008), "Models for the Financial Performance Effects of Marketing," in *Handbook of Marketing Decision Models*, Springer Science.
- Mantrala, Naik, Sridhar & Thorson (2007), "Uphill or Downhill ? Locating the Firm on a Profit Function," *Journal of Marketing*, April.

MASB

Thank-you!