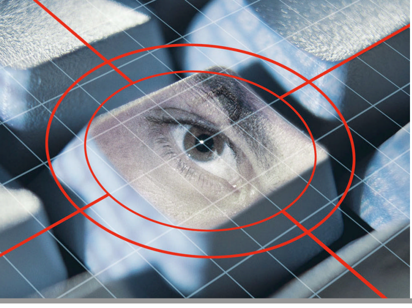


AN OCCASIONAL PAPER

MARKETING ROI

Prompted by discussion at a Media Question Time organised by the IAA, and much else that is current, we have been led to write about how the effectiveness of marketing expenditure may be determined and the role of research.

It is clear that measurement is currently dominated by two areas:

- direct response: where there is a direct connection between expenditure and sales
- on-line: where extensive metrics may be used to evaluate customer behaviour

This is largely because the figures are available and the arithmetic is simple, although there are three key issues that may be neglected:

- any action taken may not be directly related to the marketing expenditure at that time. Customers make their assumptions about a brand from the net of all their past experiences and use that to judge whether to take advantage of any individual promotion. The implication is that unless there had been prior marketing expenditure, there would be no pipeline of potential customers ready to accept the offer.
- the calculations should be done on incremental expenditure and incremental sales and take account of time-shifting of purchases and any competing marketing activity. This is usually difficult to estimate given the complex dynamics of the market place. Some sales will be delayed, the value of which should be discounted at the risk-adjusted cost of capital to the organisation
- the benefit to the company is the contribution to profit from the additional sales rather than sales value. Since this will vary by factors such as distribution channel and level of customer servicing required, many other factors should be factored in to the calculations of return

It is recognised that the ultimate measure should be shareholder value, but this is influenced by so many other factors, internal and external, that it would be very difficult to distinguish the impact of marketing expenditure – factors such as the capital productivity of the organisation and current market sentiment towards the shares. In the same way, it is difficult to estimate the value of non-financial assets, such as brand value. The main benefit of a brand position is that it reduces selling costs at the time of the sale – the customer approaches the purchase with some pre-conceived notion of how the product or brand stacks up against the product performance factors and those brand attributes that are most important to them.

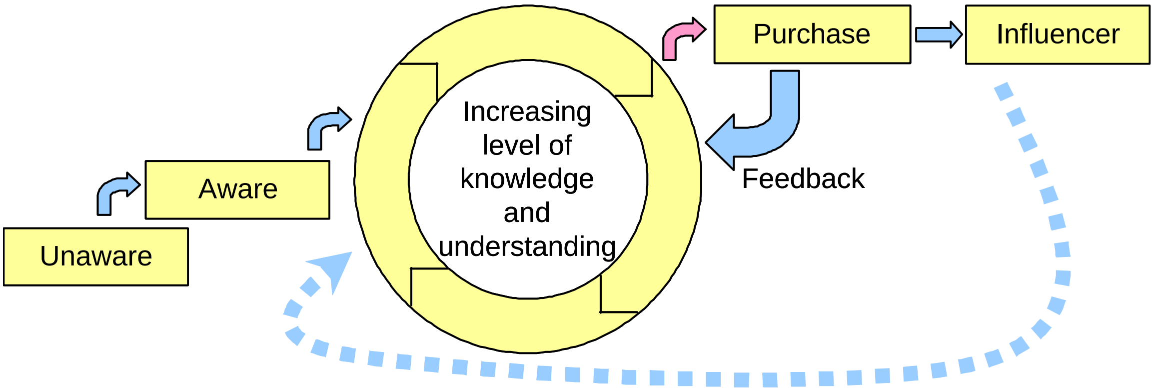
This is most clearly demonstrated in the B2B sector, where the final sale is usually undertaken by a sales person. Unless the potential customer has some awareness of the brand either it would be difficult for the salesman to gain access, or the selling process would become extended to cover the full range of decision criteria.

Customer Decision Continuum

To try to understand the cause and effect relationships between marketing activity and sales, the problem needs to be broken down into constituent parts with some attempt to identify how the parts interrelate.

Considering the steps that people go through, it is not a linear process – there are cycles of evaluation as they are exposed to each experience of the brand. These may be relatively trivial over a very short timescale in the case of an impulse purchase or part of a much longer considered process for a major capital purchase. In either case, consideration of the underlying need may have gone on for much longer and may have been influenced by the marketing activity of all competitors generating a latent demand within the market potential.

Another important factor is that there is usually a disconnect between knowledge and behaviour - the triggers for the actual purchase, the pink arrow in the diagram, may not be based on need.



The Role of Market Research

In theory, it should be possible to define customer categories according to where they are on this continuum, then to measure how many people are in each category and the average time it takes to move between categories. The effectiveness of any marketing campaign would then be the extent to which this process has been accelerated. It might be difficult to do in practice, but the modelling required to understand these dynamics will be valuable in determining a communications strategy that both keeps the pipeline full and results in greater sales over time.

The role of market research is to determine:

- the size of each category
- the dynamics in terms of speed of progress
- attitudes to their underlying needs
- their evaluation criteria and the relative importance
- their perceptions of the brand attributes and how well they compare with their evaluation criteria and the peer group
- sources of information

Campaign measures, pre- and post-campaign, should be able to detect changes in knowledge and understanding and if this can be related to the customer categories, then the net benefit from the campaign may be estimated. This should be net of:

- sales to customers who were close to purchasing anyway which should be discounted – these sales were probably the result of past campaigns
- the extent to which customers have moved closer to the purchasing decision – which may be measured in terms of the difference between the future value of the sale before and after the campaign. That is the discounted value of the sale now, less the discounted value of the sale before. If the campaign has brought forward the decision process and moved people nearer the decision point this should be a positive figure.

This would provide a common basis for measuring campaigns with different objectives. A campaign directed to brand awareness can be compared with one that results in direct sales. Even a campaign aimed at direct response will tend to generate brand awareness, so there is still some value to be gained within early-stage categories.

It may be difficult to develop models to describe this precisely, but by doing as best as is possible, the long-term benefits of marketing can be accounted for and form the basis of a justification for the marketing activities. Certainly, by attempting to develop such measures, it should be possible to be clearer about campaign objectives and develop a brief with performance metrics attached.

An Alternative Approach

Although it might not be appropriate to try this – if all marketing activity is stopped, what would happen? Nevertheless, it has been tried by companies anxious to reduce costs. In our experience, it takes 3-5 years before the company gets into real difficulties, depending on the extent of their difficulties to start with, the market in which they operate and the extent to which the sales support function can assume some of the role of marketing.

Perhaps more seriously, marketing is not just advertising and promotion – it has a key role in determining the strategy for the company to ensure that company capital is used wisely to provide products and services to meet market needs.

Justification for Marketing

Some of the concepts discussed above have origins in the financial sector, particularly in investment appraisal. Marketing expenditure is an investment since the costs and benefits tend to be in different time periods – it's just that accounting convention won't allow it to be capitalised. This is one reason for trying to estimate the value of the brand to account for the difference between the net asset value of a company and its market value.

The pressure to estimate RoI is part of the need for marketing to justify its costs and expenditure to senior management. By undertaking such analyses, it should be possible to explain the role of marketing and by adopting some of the language of the boardroom, communication may be less difficult.

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