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The Right Way to Calculate Marketing ROI

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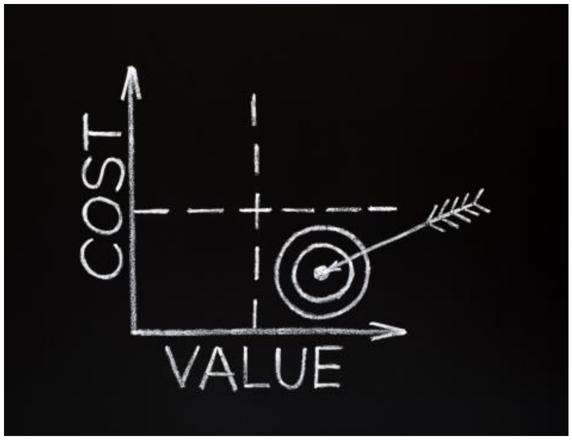
Today, accountability in marketing amounts to table stakes. Companies expect CMOs and other marketing leaders to provide quantifiable evidence (not squishy metrics such as views and eyeballs) that marketing investments are contributing to real business outcomes.

In the quest for quant-based proof, the most popular metric for marketers to invoke is ROI – or, more precisely, *marketing* ROI (MROI). Trouble is, MROI (alternatively called return on marketing investment or ROMI) is defined differently, measured differently and used for different purposes, resulting in what we might call "ROI Anarchy" across the marketing landscape. This makes the task of connecting marketing to revenue or other business outcomes even more difficult than it already is or should be.

But there's hope. In a newly-published paper, four marketing science and academic gurus have tackled the tricky topic of clarifying both the concept of MROI and how companies should go about measuring and applying it.

Paul Farris of the University of Virginia's Darden School of Business, Dominique

Hanssens of UCLA Anderson School of Management, James Lenskold of Lenskold Group, and David Reibstein of The Wharton School, teamed up to tame MROI turmoil and create a common approach to what may be the marketing profession's most critical, high-level productivity metric.



The quartet's analysis appears in just the third issue of a major new professional journal called Applied Marketing Analytics, published by UK-based Henry Stewart.

As Farris et al see it, there are three main MROI mutations that confound its use:

1. **Calculation method**: This varies greatly and might be based on a broad marketing lift assessment, funnel conversion or a cost method of some kind. And to compound the problem, calculations typically use different short- or long-term time frames.
2. **Scope**: Some go broad; others granular. Some assess return on a single marketing tactic; others the entire marketing mix. *Big difference.*
3. **Response curve level**: Finally, MROI is measured at different levels of what marketing science calls the "market response curve." For example, this might be the total return of all marketing spending; incremental return of a particular tactic; or marginal return on the last dollar spent.

Because MROI isn't a one-size-fits-all concept when it comes to real world application, the authors recommend that marketers clearly define how and what they've measured *in a specific business decision-making context* in order to derive their MROI numbers. In other words, don't pass off short-term, channel-specific ROI as adequate for informing a long-term budget or strategic business decision. It's not.

The authors define MROI as "the financial value attributable to a specific set of marketing initiatives (net of marketing spend), divided by the marketing 'invested' or risked for that set of initiatives." Here's the "formula" for how marketers should express and communicate it:

> *Our analysis measured a (total, incremental or marginal) MROI of (scope of spending) using (valuation method) over (time period).*

Connecting MROI to Business Outcomes

Connecting MROI to real world business objectives – an area where many marketers stumble – is a key concern. Calculating MROI *oblivious* to the business objectives context is like trying to keep a game score without even knowing what sport you're playing – a fruitless endeavor to be sure.

But the picture that emerges from a more clearly defined MROI might shock some CMOs. That's because marketers tend to assume that maximum ROI necessarily translates into maximum short- and long-term profit. But it doesn't. Oops!

For example, MROI plays one role in the strategic realm of setting marketing budgets, and a vastly different one in the more tactical maneuvers around allocating those investments across marketing channels and activities. Marketers sometimes forget (or ignore) the need to frame MROI in context of a "hurdle rate" – the minimum return the company should expect from a given level of marketing investment.

The idea is to maximize *profit*, not necessarily MROI. It's basically the difference between being *efficient* (obtaining high MROI) and being *effective* (driving maximum profit and long-term value). As the paper points out, maximizing profit isn't a simple matter of shifting marketing investments from low- to high-ROI activities.

That's because you must also consider strategic issues such as brand building and new customer acquisition vs. the need for short-term sales, among others.

The main implication for management is this: MROI – calculated correctly – is a valuable tool that recognizes money spent on marketing is an *investment* (vs. an expense) and a means to apply accountability in marketing.

In short, this is one academic paper that's a must-read for marketers of all stripes who want to truly understand and credibly calculate MROI.

Click here to download a complimentary digital copy of the full paper.

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