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optimising your marketing spend

Using ROI to get the best results

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In brief

Ensuring optimum results from your marketing expenditure is notoriously difficult for any business, large or small. Your forecast return is a guess at best. Even the actual results can be hard to quantify. For that reason, it pays to first analyse what funds you have available before you examine what you can do with them. Using ROI techniques puts financial parameters around your campaign and sets benchmarks against which you can judge your success.

The science behind this art is growing. The internet has led the way by providing easy access to data. It lets you find out how many people have clicked through to your site, from where, how often they visit, what they have looked at and whether they bought anything. A click-through-to-sale campaign, in which you only pay for an internet ad when someone actually clicks through and finally buys something, is the obvious example. You know exactly what the sale has cost you, or alternatively, how much you had to pay to buy that extra customer. But there is nothing new with this notion. The local retailer who makes a letterbox drop of discount coupons knows exactly how effective it is by adding up the number of people who bring in the coupon and cash it in with a purchase. Same principle.

The other principle that applies to both examples, and any marketing campaign for that matter, is that the net return of the exercise must exceed the net expenditure on it. Nothing new there either.

The simplest starting point to get this right is to work out how much you have got to spend. To do this, you need to work out your Variable Profit Margin. This is simply how much net margin does the one extra sale generate after you have deducted the cost of sales of making that extra transaction. Ignore fixed costs, but deduct every other input cost that is required to deliver that extra unit. If your product sells for $100 and it costs $75 to produce and deliver that product, then your VPM is $25, or 25%. That's how much you have available to spend on promotion. Spend it all, you break even. Spend less, you make money. Spend more, you lose money.

You may have the brightest marketing idea, but it has to add value. If you design a campaign which targets a particular number of additional sales, your VPM will tell you how much money you can spend on the project for it to make a positive return on the investment.

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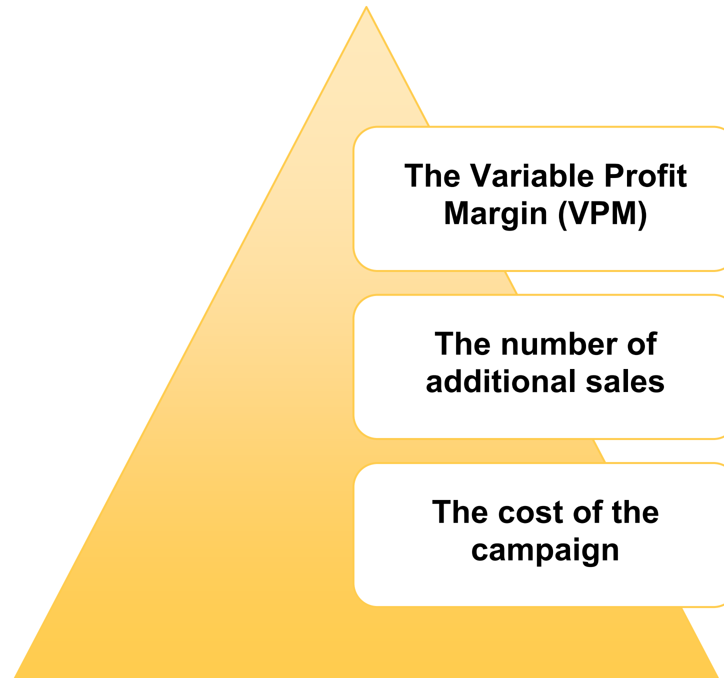
What you need to know

Three simple calculations



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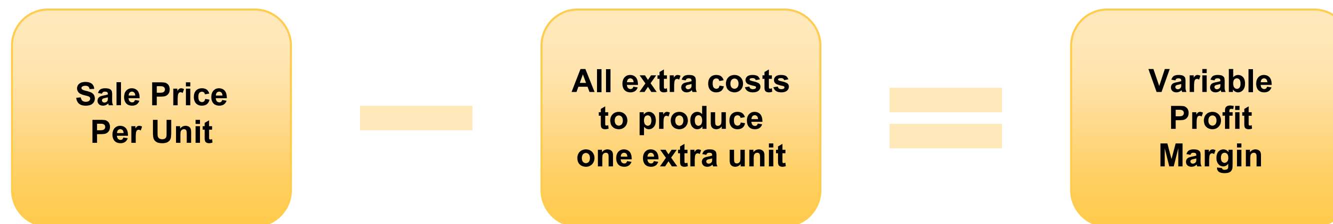
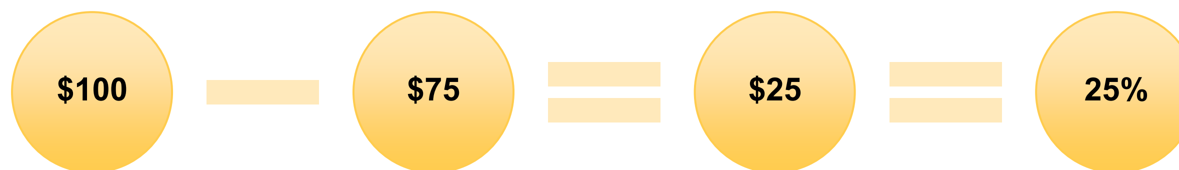
The Variable Profit Margin

What does it cost to deliver an extra unit?



For example:



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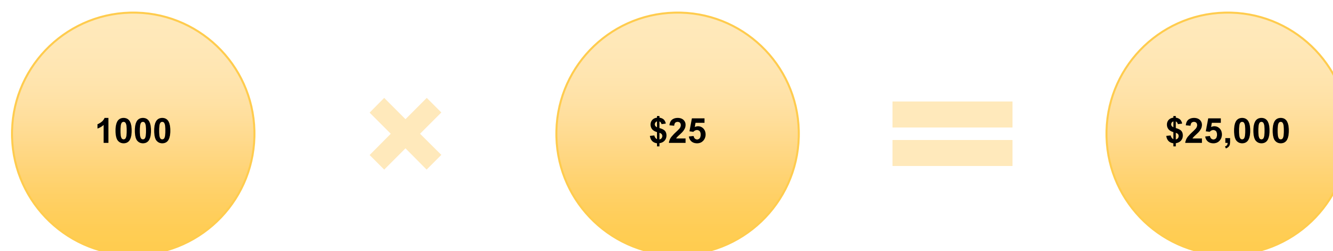
Funds available

How much have you got to spend to break even?

For example:



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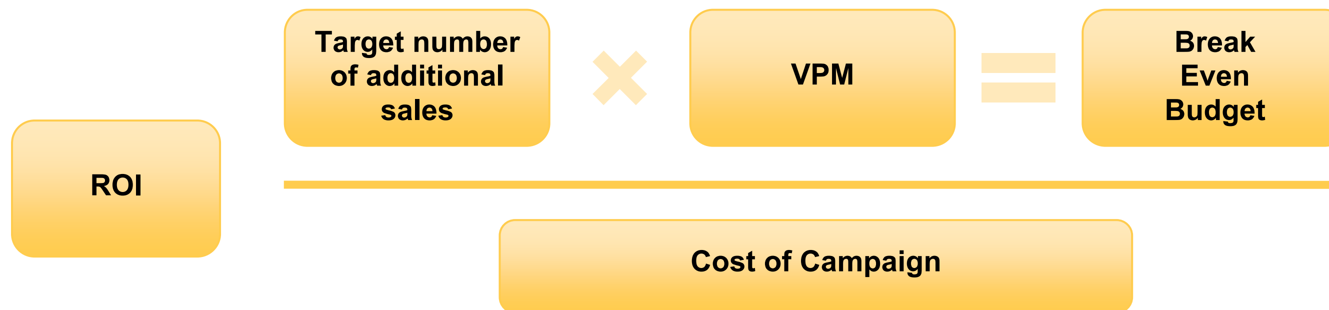
Working out your ROI

What's the percentage return on the campaign spend?



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How is this useful?

- Clearly you will only have a positive ROI if your campaign spend is less than your total VPM. In our example, if the total spend on the campaign is $20,000 rather than the break even budget of $25,000, then the return on the investment is 25%, as below:

$$\text{ROI} = \frac{\text{VPM x Additional Sales - Cost of Campaign}}{\text{Cost of Campaign}} = \frac{\$25 \text{ x } 1000 - \$20{,}000}{\$20{,}000} = \frac{\$5{,}000}{\$20{,}000} = 25\%$$

- How is this useful? Knowing your ROI let's you assess the value of spending the money. It adds discipline to making the investment decision. Is the project worth the trouble? How does it compare with spending the same amount of money on promoting some other product or service, or for that matter, on some other completely different project like buying new plant and machinery.

- This process forces marketing plans to face the same financial music as any other investment decision. It can be a sobering perspective amidst the excitement that marketing projects often generate. At the planning stage, the ROI is always going to be a forecast, and thererfore most likely wrong. But it focuses attention on the assumptions you are making and highlights the NET result versus the GROSS result.

- Equally important is the analysis after the event. It is only by tracking returns from all campaigns that you can scientifically identify what activities produce the best result for the product and the firm. Over time, ROI analysis, both pre and post investment, lead to marketing strategies that optimise the return on the marketing budget.

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Hi, I'm Alan Hargreaves. I specialise in simplifying complex business problems. In over 35 years as a business executive, I have never found an issue that cannot be addressed through identifying the essential but simple steps required to make any problem manageable. It might be your career, your firm, your team or your strategy. It doesn't matter. All hurdles can be lowered through dispassionate analysis, and all executives can embrace simple processes to take them forward.
Using these techniques, I have helped hundreds of people through the various stages of their business or career development. It may be the challenge of taking on new responsibilities; it could be the task of managing a business you have created yourself; it may be handling a difficult team in the midst of major change. I use a straightforward combination of key principles to get results: collaboration, adaptation, simplification and action. You can contact me anytime at alan@alanhargreaves.com.

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